



CITY OF SUNNYVALE

DEPARTMENT OF FINANCE

October 12, 2006

TO: Honorable Mayor and Members of the City Council

FROM: Mary J. Bradley, Director of Finance

THROUGH: Amy Chan, City Manager

SUBJECT: **October 17 Study Session for Update of Fiscal Sub-Element**

In advance of the upcoming Study Session on October 17 to review the proposed Fiscal Sub-Element, the draft document is attached for your review and consideration. This Study Session follows the previous session held on July 18. Its purpose is two-fold: to obtain additional Council comments on the draft and, importantly, to receive Council approval to release the document for public review.

At the previous Study Session, staff presented to Council the draft Financial Policies, without the supporting explanatory and historical text. The document is now being presented substantially in its final form. The draft Financial Policies have been revised to incorporate Council's initial comments. Additionally, the City Manager and Executive Leadership Team, along with key staff members, have preliminarily reviewed the entire draft, and their comments have been incorporated into the document.

The draft document contains several sections that provide context for the City's Financial Policies. These sections describe the City's Financial Management Structures, such as the Planning and Management System (PAMS) and Long Term Financial Planning. They also discuss Sunnyvale's fiscal health, and describe the processes that help guide the City's fiscal decision-making. The document also includes key Fiscal Indicators which provide the reader with such financial data as total revenues and expenditures, the City's Issuer Credit Rating, per capita Sales and Property Tax, etc. In addition, the document outlines the City's Long Range Goals. Finally, the document outlines the City's Financial Policies.

Subsequent to the October 17 Study Session, the draft Fiscal Sub-Element will be presented to the Planning Commission at Public Hearing on Monday, October 23. Staff will then return to the regularly scheduled Council meeting on November 14 for final Public Hearing and approval.

While the attached draft document is nearly complete, staff is in the process of completing graphics that will be added prior to the November 14 Public Hearing. Following the Study Session, the City Manager will undertake a final review to ensure that, to the best extent possible, all recommended revisions have been captured and to certify that the document is ready for final Council consideration. We welcome your input and insight into this important City document, and look forward to the next level of review.

Draft

FISCAL SUB-ELEMENT

of the General Plan

City of Sunnyvale

October 17, 2006

**Sunnyvale Department of Finance
Sunnyvale, California**

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INTRODUCTION

The availability of funding, and its appropriate use, guides all aspects of City government. Every service provided or good purchased, every person hired, every capital improvement built and financed depends on the City's continued ability to raise and prudently spend its revenues. The Fiscal Sub-element of the General Plan establishes the policy framework upon which all of these short and long-term financial decisions are made.

In California, all cities are required to prepare and maintain a General Plan outlining the direction of the community. The law mandates seven elements, or subject matter, to be included in the Plan: land use, circulation (transportation), housing, conservation, open space, noise, and safety. Communities may combine these required elements into one or more documents, so long as there is consistency within and among the documents.

In Sunnyvale, the General Plan goes beyond basic compliance with State law. The City has made the General Plan its central policy document and, through its overall Planning and Management System, has incorporated general planning into the total fabric of local governance. Virtually every major activity that the City undertakes is incorporated into an element or sub-element of the General Plan. The Fiscal Sub-element contains the City's financial policies and thereby provides the overall framework upon which all fiscal decisions are made to achieve the goals laid out in each of the Plan's elements.

Purpose of the Fiscal Sub-element

The Fiscal Sub-element of the General Plan establishes the policy framework necessary to guide all of the City's short and long-term fiscal decisions. In addition to identifying the policies that City officials will follow in conducting the financial affairs of the City, it serves as a planning document to assist in making fiscal decisions from a comprehensive perspective. It is intended to ensure that the fiscal aspects of policy issues are considered whenever and wherever possible. It does so by establishing clear relationships between City goals and policies and their fiscal needs and impacts.

In particular, the Fiscal Sub-element:

- Defines and describes the City's financial planning structure, including its:
 - Planning and Management System (PAMS),
 - General Plan orientation and philosophy,
 - Sunnyvale's Approach to Budgeting:
 - Long-Term Financial Planning
 - Performance Based Budgeting
 - Full Cost Accounting of Services

- Performance and Financial / Operational Auditing
- Use of Reserves
- Capital Improvement Planning
- Revenue Management
- Expenditure Management,
 - Accounting and Financial Reporting Practices,
 - Purchasing, and
 - Debt Management
- Analyzes the City's past and present fiscal health, and projects its future fiscal condition;
- Identifies the Long Range Goals needed for fiscal sustainability and establishes the Action Strategies necessary to achieve these goals; and
- Sets forth the City's Financial Policies.

Format of the Fiscal-Sub-element

The Fiscal Sub-element is arranged in several sections designed to take the reader through a logical progression of information that provides the proper context for the City's established Financial Policies. The first section is **Fiscal Conditions**. This section provides the background necessary to understand Sunnyvale's complex financial planning structure. It identifies the past, present and future fiscal health of the City by examining various City Funds and the City's Revenue Base. The fiscal health of the City provides an important discussion on the limitations that California municipalities face in raising revenues. Next, the Fiscal Conditions section describes financial tools, controls and practices required for prudent financial management in the future. The tools, controls and practices identified will be further addressed in the City's Financial Policies.

Also included in the Fiscal Conditions section are the City's Fiscal Indicators, which are important measures of Sunnyvale's fiscal health. Examples of fiscal indicators include items like the City's Issuer Credit Rating for debt issuance, per capita revenue information, and total assessed valuation of property in the City. These indicators are calculated annually, and provide essential trend information that will complement the City-wide community condition indicators.

The next section establishes the City's **Long Range Goals**. This section describes in broad fashion the basic requirements needed to maintain long-term fiscal stability, and outlines a vision for the City's future fiscal sustainability.

The next section identifies the City's **Financial Policies**, which form the cornerstone of all the City's financial decisions and serve as a guide for the City Council and staff in making prudent short and long term financial decisions. These policies are organized according to the applicable Long Range Goals.

The last section discusses the specific **Action Strategies** that the City will employ to achieve its long range goals over the near term.

FISCAL CONDITIONS

BACKGROUND – FINANCIAL MANAGEMENT STRUCTURE

Financial management in the City of Sunnyvale is supported by a number of City-wide systems and processes that impact every financial decision made. The framework of systems and processes used by Sunnyvale is known as the Planning and Management System, or PAMS. PAMS consists of various components designed to integrate every major function in the City. The systems provide a structure that ensures accountability to the community for services provided.

Sunnyvale also maintains a system of internal financial management practices and controls that support sound fiscal stewardship. These include accounting and reporting practices, a centralized purchasing system and prudent debt management.

PLANNING AND MANAGEMENT SYSTEM (PAMS)

Sunnyvale's Planning and Management System, or PAMS, is a comprehensive blueprint that ties together every major activity in the City by providing the necessary linkage between City Council goals and policies as reflected in the General Plan and the allocation of finite resources through the budget process. PAMS provides a framework in which the City plans, performs, evaluates and audits the services provided to the community in a systematic and quantifiable manner to promote accountability.

PAMS provides information to the citizens of Sunnyvale on the value the community receives from various public expenditures. Government entities such as Sunnyvale use public resources (land, money, people, and equipment) to provide community services and facilities. PAMS helps to define what success looks like in Sunnyvale by establishing performance measurements for each service to be provided. These performance measurements emphasize effectiveness and efficiency of operations along with customer satisfaction and budgetary responsibility. Actual results for each program are reported, and employees are evaluated on those results. A performance auditing system is also in place to verify the results reported.

GENERAL PLAN

The General Plan is a prescriptive document that identifies the desired future for a local jurisdiction. It is both a statement of purpose and a statement of general direction. As a statement of purpose, the General Plan portrays a vision of the future city and identifies its long-range goals. As a statement of direction, it declares the current policies of the City Council to achieve the goals, and the strategies which the staff will deploy to implement those policies. The General

Plan not only paints the picture of the desired future city, but also prescribes a course of action for moving from existing conditions to desired conditions.

In California, State law requires all cities to prepare and maintain a General Plan. The law mandates seven elements, or subject matter, to be included in the Plan: land use, circulation (transportation), housing, conservation, open space, noise, and safety. Communities may combine these required elements into one or more documents, so long as there is consistency within and among the documents. Communities may also incorporate within their Plan other elements, such as Financial Policies, which are of particular local concern.

Sunnyvale views the preparation of the General Plan to be more than mere compliance with State law. It has made the General Plan its central policy framework and, through its overall Planning and Management System, has incorporated general planning into the total fabric of local governance.

It is the vision and goals of the General Plan which give meaning and direction to the City's 20-year Resource Allocation Plan and which provide the framework within which shorter-range strategic planning takes place. Short-range strategic planning translates the long-range, somewhat abstract goals of the General Plan into action strategies which address the current issues facing the City. These action strategies, in turn, guide the rational allocation of scarce resources through the budget process to those actions and services which can most cost-effectively meet the needs of the community and achieve the desired results.

SUNNYVALE APPROACH TO BUDGETING

The City Charter requires the City Manager to prepare an annual budget and submit it to the City Council at least thirty-five days prior to the beginning of the fiscal year. The Council must adopt the budget on or before June 30th of each year.

In addition, the City prepares a Twenty-Year Resource Allocation Plan to ensure that finances are managed to maintain service delivery levels set by Council over the long term. This Plan also establishes reserves necessary to meet known and unknown future obligations. The City projects revenues, operating expenditures, and capital spending over the twenty-year period to provide the City Council with a tool for addressing fiscal challenges in a measured and thoughtful way.

The City uses a Performance-Based Budget system which integrates long-term planning with resource allocation by budgeting for activities to meet intended service levels which accomplish General Plan goals. Work hours, products and performance measures are recorded to determine and evaluate the efficiency and effectiveness in accomplishing budgeted activities. Full costs of all programs are identified, including the use of assets such as equipment and buildings, and charges are collected to provide for their orderly replacement.

This integrated framework has enabled the City, over time, to accomplish the long-range strategic goals established by the Council in the General Plan Elements and Sub-elements. This system has assisted the City in maintaining, and even expanding, services during times of numerous Federal/State mandates and revenue restrictions or reductions because the focus is on long-term fiscal management. The Sunnyvale approach to budgeting has also served as a valuable tool in producing and capturing remarkable gains in efficiency and productivity. It supports Sunnyvale's mission of providing the highest possible quality services with the lowest possible cost to its community.

In order to accommodate this comprehensive approach with limited staff resources, Sunnyvale adopted a two-year operating budget concept beginning in FY 1982/1983. Under this approach, the focus is on the operating budget in one year, and then the capital projects budget in the next. By doing two-year budgeting, a more in-depth review of each budget element can be conducted. Although Sunnyvale was one of the pioneers in this concept, today two-year budgeting has become much more common among cities.

Long-Term Financial Planning

The Fiscal Sub-element of the General Plan prepared in 1988 required that the City Manager annually propose a budget balanced not only for the budget year, but also for a ten year planning period. Since FY 1993/1994, Council has approved a financial plan that has been balanced to the twentieth year. The practice of twenty-year financial planning is now being memorialized in the Fiscal Sub-element.

While annual budget review and approval is a sound business practice and is required by the City Charter, an understanding of the City's long-term financial picture is more important to the process than just looking at a one-year or two-year snapshot. The long-term nature of the City's financial planning system allows decision-makers to better understand the true effect of policy decisions. Because City practice has been to prepare a fully balanced twenty-year financial plan, it effectively requires that decisions made today guarantee that the resources will be available to provide quality services in the future. The Twenty-Year Resource Allocation Plan prevents wild swings in service levels during the upturns and downturns of economic cycles. It also forces a more thoughtful decision-making process, avoiding emotional or knee jerk reactions.

The City's long term approach is also reinforced by the Study Issues process, which provides a method for identifying, prioritizing and analyzing policy issues important to the community. The process allows the City Council to annually consider and rank the many issues that are raised each year in order to set priorities for study within resource allocation limits. The Study Issues process was designed to provide the Council with a method to separate those issues that

may have seemed important when they were first raised from the truly critical issues that require detailed examination. Importantly, the process allows City staff to thoroughly review proposed study issues to help determine the short and long term impacts that proposed new services will have on existing Council approved service levels.

Performance Based Budgeting

The performance based budgeting system is an important part of Sunnyvale's financial management and planning structure. The City began to implement this management concept in the late 1970's by incorporating a system of budgeting that focused on the "outputs" resulting from service provision. This system was further refined in the 1990s to identify and quantify the value created from the efficient/effective provision of City services, with the focus shifting from "outputs" to "outcomes."

At the heart of the performance based budgeting system in Sunnyvale is the identification of services provided and the measurement of their effectiveness and efficiency. Resources are not allocated by department or by line item, but instead are allocated to each program by specific activity in order to accomplish the level of service established by the City Council. Performance measures for each program are set to provide information on its quality, productivity, cost effectiveness and adherence to budget.

The City's budget system allows City staff and policy makers to identify and manage productivity. For each service that the City provides, the product cost is identified along with productivity measures such as staff hours per product. Program managers monitor these costs throughout the year to make sure that all services are accomplished as efficiently as possible.

In FY 2003/2004 Council requested that staff complete a comprehensive review and analysis of the outcome approach. The review and analysis of the system began early in FY 2004/2005 and was completed by the end of FY 2005/2006. The Adopted FY 2006/2007 Budget now reflects the enhanced and restructured Performance Based Budgeting system.

Full Cost Accounting of Services

Sunnyvale's budgeting system provides for full cost accounting for all City services. The direct cost of each activity includes work hours, materials and supplies, all personnel costs, and the support costs of internal service programs. The City utilizes two internal service funds, the General Services Fund and the Employee Benefits and Insurance Fund, to account for goods and services provided by one department or agency to other departments or agencies of the City. Sunnyvale's full cost accounting methodology results in all of the costs of

these funds being charged back to user activities on a rental rate or additive rate basis.

The General Services Fund provides City-wide fleet, building maintenance, and technology and communication services and charges rental rates to the operating programs which benefit. The rates include not only the cost of operating these services, but also the cost of replacing depreciable equipment. This assures the availability of funds to replace equipment at the most cost-effective time.

The Employee Benefits and Insurance Fund provides a mechanism to charge expenditures related to pension costs, employee insurance plans, and workers compensation costs and leave time to each program. This is accomplished by charging an additive rate to staff salaries wherever personnel hours are budgeted.

Performance and Financial/Operational Auditing

As part of its overall Planning and Management System, the City of Sunnyvale maintains a systematic schedule of performance and financial/operational audits. Regular performance audits of each operating program are conducted to ensure the integrity of results that are annually communicated to the public. It is currently Council policy that every program will be audited at least once each eight years.

In addition, the City performs fiduciary compliance audits which carefully review the City's financial and operational procedures. These reviews are designed to identify and fix inefficiencies and to quickly address issues that can lead to waste, fraud or abuse. Sunnyvale's auditing program provides assurance to the public that precious City resources are being spent wisely on their intended purposes.

In FY 2004/2005 the City embarked on a program of optimal staffing studies by department to ensure that staff resources are used in the most cost-efficient manner. The first department was Public Safety. The next study was Public Works, which will be completed in October 2006. Currently, an optimal staffing study of the Information Technology is underway, with completion expected in FY 2006/2007. In the future, the plan is to perform these studies on every City department.

Use of Reserves

One of the most powerful aspects of the City's long-term planning approach is its ability to recognize trends over time and begin at an early point to take steps to respond to them. The use of reserves is pivotal to this long-term planning strategy. Reserves may be established for any of the purposes listed below:

- To provide for contingencies or emergency situations

- To levelize the impact of the cyclical nature of the economy and maintain service levels over the long term
- To accumulate resources for specific purposes such as debt service, equipment replacement, or capital improvements
- To smooth cash flow or stabilize rates
- To provide funding for long-term liabilities
- To segregate funds that are legally restricted

The level of funding for each reserve is an important policy decision for City Council and should be appropriate to the City's particular circumstances.

Capital Improvement Planning

Capital projects are major expenditures related to construction, improvement, or acquisition of capital assets. The assets can be in such forms as buildings, streets or street-related infrastructure, parks, and the various elements of the utility systems. The Capital Improvement Plan (CIP) projects the City's capital needs over a 20-year term. In the CIP development process the priority of projects is established and financing requirements are estimated to ensure that scheduled projects have available resources. The future operating cost or savings of each project are also identified, and these are reflected in the Long Term Financial Plans to ensure that funds will be available to actually operate the new facilities. A capital budget is adopted by Council each year to provide funds for projects scheduled for that year.

Capital improvement projects typically are costly, have a long life, and are highly visible to the community. For these reasons, it is important that the projects be designed to ensure that they are cost-effective while at the same time meeting the needs of the community. Once constructed, the asset should be maintained so that future repair and replacement costs are minimized. The City has a Long Range Infrastructure Plan in place that contains each city asset and projects when it will need to be repaired or replaced. This effort will prevent the City from major liabilities in the future resulting from deferred maintenance of its infrastructure assets.

Revenue Management

The City of Sunnyvale has long recognized the importance of effective revenue management policies to maintain or even enhance fiscal strength and stability over both short and long term planning horizons. These policies address such areas as revenue diversification, stability, and elasticity, tax equity/fairness, appropriate levels of cost recovery for user fees, accurate forecasting, and aggressive collections systems.

The two major categories of revenues received by government are taxes and fees, each with important distinctions. In order to levy a new tax or increase an

existing tax, local governments must hold an election to obtain voter approval, while fees may be imposed without a public vote. The taxes collected by the City primarily support general governmental purposes. In other words, tax revenues pay for basic and/or essential services.

User fees, in contrast, are charges imposed for discretionary services that benefit a specific segment of the community. Fees are distinguished from taxes in two principal ways. First the amount of the fee may not exceed the cost of providing the service, while the amount of a tax has no such restriction. Second, the service for which the fee is charged must bear a relationship to the person or entity paying the fee. In general, user fees are reviewed annually and set by the City Council to recover the full cost of providing a particular service. The Council may choose to charge a fee for service that does not recover its cost in order to fulfill a specific public purpose. User fees are published in the Annual Fee Schedule for reference by the public.

All City revenues are forecast for the full twenty year planning cycle. Revenue assumptions and projections are reviewed and revised each fiscal year, with attention paid to the key elements that impact the revenue sources so that the projection methodology is reliable over the long term. City staff continually monitors the collection of revenues, including annual revenue audits, in order to ensure maximum receipt of all funds legally due to the City.

Expenditure Management

Once the operating and capital budgets have been prepared and adopted by Council, staff is responsible for closely monitoring the expenditures and results each accounting period to ensure that resources are being used as effectively as possible to maintain desired service levels. To assist in this monitoring, the City's financial system provides a Program Progress Report (MBO) each accounting period which identifies hours and costs for each activity. Information on productivity (hours per product) is also included. Managers review this information and take any corrective action necessary to maintain the program cost and efficiency goals.

By Council policy, appropriations are made to each operating program by fund and to each separate project. Any changes in appropriation for program above a Council-established threshold require Council approval, while changes below that threshold can be approved by the City Manager.

Article XIII B of the California Constitution, approved by the voters in 1979 as Proposition 4, placed limits on the amount of revenue which can be spent by government entities. The Proposition also established a formula for annual calculation of the appropriation limit. Each year the City calculates its appropriations limit, which is adopted by Council as part of the budget approval. The City has never reached or exceeded its appropriations limit, and in recent

years has adopted expenditures at a level substantially below the allowable maximum.

ACCOUNTING AND FINANCIAL REPORTING PRACTICES

The City's Charter requires that an annual financial audit be conducted by an external auditor. The City is also required by Charter to prepare and issue a Comprehensive Annual Financial Report (CAFR). The financial statements are presented in conformity with generally accepted accounting principles (GAAP) and audited in accordance with generally accepted auditing standards. While traditionally addressed to the City Council, the annual financial audit is also intended to provide relevant financial information to Sunnyvale residents, City staff, creditors, investors, and other concerned readers. The City maintains its financial records in accordance with standards set by the Governmental Accounting Standards Board (GASB), and implements all recommended GASB pronouncements.

The City's CAFR has received an unqualified opinion from the auditors each year and has been awarded the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA) since 1985. GFOA is the national association representing state and local finance professionals in the United States and Canada.

A system of internal financial controls is essential to assure that management is accomplishing its objectives and meeting its responsibilities. Public sector managers have a duty of stewardship for the resources entrusted to their care. The City has put financial practices in place which take every reasonable precaution to prevent the misuse or diversion of public funds. Each year as part of the independent audit process, the external auditors test the City's internal controls, and no issues have been found.

PURCHASING

The City Charter establishes a centralized purchasing system for all City departments. The Sunnyvale Municipal Code defines this system in detail, including responsibilities, authorized methods of procurement and competitive bidding requirements. This centralized purchasing system offers a number of benefits to the City. In 2000 Council adopted a state-of-the-art Purchasing ordinance as well as the City's first Public Works Contracting Ordinance.

Through this system the City maintains fair and equitable practices that encourage qualified suppliers and contractors to compete for City business. Also, it is a high priority to receive maximum value for each public dollar spent. The centralized purchasing system enables this by promoting cost effective, efficient and ethical business practices throughout the organization. The City participates in cooperative procurements with other governmental agencies

which make cost savings possible through volume purchases. The end result is that the centralized purchasing system safeguards the quality and integrity of the City's procurement processes.

The Sunnyvale Municipal Code allows for a 1% bidder preference for materials and supplies that are purchased from Sunnyvale vendors. This preference has been extended to recognize the 1% Sales Tax that will be returned to the City in these transactions. Currently, the City is studying other ways of increasing purchases from local vendors and has embarked on a one-year outreach program. In this effort, staff is identifying commodities or services that are available from Sunnyvale businesses and encouraging Sunnyvale businesses to participate in the City's competitive bidding process. City departments are also being encouraged to procure products and services that are exempt from competitive bidding from Sunnyvale vendors wherever possible.

DEBT MANAGEMENT

When debt is issued, the borrowing government becomes obligated to make regular debt-service payments for periods of 30 years or more. For this reason, debt service can impact a government's financial condition over the long term more than any other type of expenditure. It can also limit the government's flexibility to respond to changing service priorities or funding availability. As a result, policies are needed regarding the circumstances under which debt should be issued, limitations on the size of total debt and debt service, the types of debt that can be utilized, and the management of a debt portfolio.

In California, a variety of debt financing methods is used by municipal issuers to raise funds for capital projects. These include Certificates of Participation, Lease Financing, Revenue Bonds, Special Benefit Assessment Bonds, and General Obligation Bonds. Each of these has specific legal requirements regarding projects eligible for financing and sources of payment. Over the years, State law has limited the flexibility that cities have for issuing debt, particularly in the area of General Obligation Bonds. These Bonds, which are limited to the acquisition of and improvements to public land and property, involve the imposition of an additional ad valorem tax on property which must be approved by 2/3 of the voters participating in the election.

Sunnyvale's Charter limits the total general bonded indebtedness to 15% of the total assessed valuation of property within the City. In practice, the City has issued debt on a very limited basis over the years and the total debt burden is very small. This conservative approach has resulted in the City maintaining a very strong overall credit rating with the national credit rating agencies. This rating, in turn, insures that borrowing can be done at very favorable rates.

FACTS & FINDINGS – FISCAL HEALTH OF THE CITY

The Fiscal Health of the City contains two sub-sections. The first, Overview by Fund, is a review of the major City funds. The second sub-section is titled City's Revenue Base. This sub-section provides a summary of the City's current major revenue sources.

Overview by Fund

The City's resources are organized on the basis of funds, which are used to segregate monies that have specific purposes or limitations. Resources are allocated to and accounted for in these individual funds based upon the purpose for which they are to be spent and the means by which spending activities are controlled. Generally accepted accounting principles for local governments classify funds into three types: Governmental, Proprietary, and Fiduciary.

The General Fund is the largest fund in the Governmental group of funds, and accounts for all resources not otherwise devoted to specific activities. This fund receives the City's general tax revenues and finances the majority of municipal functions, including police and fire services, parks maintenance, street maintenance, library services, human and social services, community development programs, economic development, neighborhood services, and the general administration. Other governmental funds include the various Special Revenue funds, which account for the proceeds of revenue sources that are legally restricted to expenditures for specified purposes. Examples of Special Revenue funds include the Gas Tax Fund, the Park Dedication Fund, the Community Development Block Grant Fund, and the Youth and Neighborhood Services Fund.

The City's Proprietary funds consist of Enterprise funds and Internal Service funds. Enterprise funds incorporate programs and activities that are either fully self-supporting by way of user fees and charges or partially self-supporting. The City's Enterprise funds include the Water, Wastewater, and Solid Waste utilities and the Community Recreation Fund. Internal Service funds account for the financing of goods and services provided by one department to another. In general, these proprietary funds are operated like private businesses, where the costs of goods or service are paid for by the users. Internal Service funds have been established for fleet, computer services and equipment, facility management services, and various personnel-related costs such as pensions and medical benefits.

The City has a small number of fiduciary funds which hold assets in a trust or agency capacity for others. These funds are custodial in nature. The current fiduciary funds used by the City are the Swirsky Youth Opportunity Fund and the Fremont Pool Fund. In both cases, the interest earnings on the fund assets are used to support specified programs.

Contained in this section is a review of each of the City's Governmental and Proprietary funds. Analyses of revenue and expenditure trends are provided as a context for the City's current operating environment. This review is supplemented with general commentary on the factors that impact each fund.

Many of these issues may have a significant effect on the City's long-term financial health.

GENERAL FUND

The General Fund is used by the City to account for all financial resources except those required by law or practice to be accounted for in another fund. The Fund supports many of the most visible and essential City services, such as police, fire, road maintenance, libraries, parks and open space maintenance, neighborhood services, and human and social services. General government support functions are also included in this fund, and their costs are apportioned through the use of in-lieu fees to other City funds.

About 65% of the programs in the City are operated within the General Fund. Public Safety programs such as police, fire, and emergency medical services comprise approximately 57% of General Fund operations. Public Works activities such as streets, sidewalk, and streetlight maintenance, street trees, and traffic and transportation services represent about 12%. Certain General Fund programs generate revenues to support part or all of their cost; development-related activities such as permitting and inspection, for example, are fully supported by Building Permit and other construction-related fees. However, most General Fund operating programs are supported, for practical purposes, largely from General Fund tax sources (i.e., from Property Tax, Sales Tax, Transient Occupancy Tax, etc.) Those General Fund activities which provide administrative support to the Utilities are reimbursed by the fund served. For example, the General Fund is paid for all of the Utility Billing, Collection and Revenue Management program in the Department of Finance by the benefiting utilities.

The General Fund has a very close relationship with several other funds. Those funds are the Community Recreation Fund, the Youth and Neighborhood Services Fund, the Gas Tax Fund, the Internal Service Funds, the Capital Projects Fund, the Infrastructure Renovation and Replacement Fund, and the Redevelopment Agency Fund. In each case, the condition of these funds has a direct bearing on the General Fund due either to contractual relationships or because the General Fund is a primary or significant source of financial support. These relationships are reviewed in the discussion of each fund.

Of particular note is the financial relationship between the General Fund and the Community Recreation Fund. The FY 2006/2007 budget provides approximately \$12 million in diverse recreation programs and services, with the General Fund providing about \$3.9 million of this amount. Preparation of this budget included a realignment of recreation services provided in each fund so that the services would be reflected in the most appropriate fund. This exercise was undertaken to better define and allow more control over the services and activities that are provided in the Community Recreation Fund.

The cost for employees, both in salaries and benefits, has increased significantly since the last Fiscal Sub-element was completed in 1988. The increase has resulted from several factors, including the continuous rise in medical insurance costs, the effects of CalPERS retirement plan contribution rates, and the upward pressure on salaries and wages in the Bay Area because of the high cost of living. For FY 2006/2007, salaries and benefits represent approximately 80% of General Fund operating costs.

While personnel related costs have risen, actual total work hours city-wide has decreased very slightly since FY 1987/1988. This means that the number of City employees has remained relatively constant but the cost of these employees has increased significantly.

In constant dollars, operating costs of the General Fund in FY 2006/2007 are projected to be 32% greater than operating costs in FY 1996/1997. Operating costs include salaries and benefits, purchased goods and services, property and capital outlay, and internal service charges for support services such as fleet, information technology, and facilities. Personnel cost increases over the past five years, particularly benefits costs, have been the primary driver for the significant increase in operating expenditures.

These increases in General Fund operating costs have occurred in spite of the dramatic economic downturn starting in FY 2002/2003 which required Sunnyvale to make unprecedented budget reductions. Some \$15 million in program and project reductions and revenue increases were put in place effective with the FY 2003/2004 budget to address the City's new lower fiscal reality. In the last few years a modest economic recovery has enabled the City to add back certain high priority services and increase service levels in selected areas.

Since FY 2003/2004 the Long Term Financial Plan for the General Fund has included several other fiscal strategies designed to balance the gap between revenues and expenditures. Of note is the fact that in November 2005, Sunnyvale voters approved increases to the City's Transient Occupancy Tax and Business License Tax rates, which were lower than those of most of our surrounding communities. These two revenue increases provided additional resources to continue services at the current levels. Even with the increased rates for Transient Occupancy Tax and Business License Tax Sunnyvale's local tax rates will still be among the lowest in Santa Clara County.

With the various actions discussed previously, the long-term financial health of the General Fund seems to have stabilized. However, Sunnyvale will continue to face a number of fiscal challenges in the upcoming years. In addition to the rising employee costs noted above, the challenges include: Library facilities and programming needs; the need for Civic Center replacement or renovation; aging facilities and infrastructure; the need for services based on changing

demographics of the population; and the continuing uncertainty surrounding the redevelopment of the Sunnyvale Town Center Mall and Downtown Sunnyvale.

The City recently completed a preliminary exercise which indicated that our Library facility and collection are not keeping up with the growing demand for our services. During FY 2006/2007 the Library staff is undertaking a "Library of the Future" visioning process to identify what the Sunnyvale community will need from library services over the next decades. This may result in a need for substantial new services or facilities in the near future. In addition to potential significant capital costs for replacement, rehabilitation, or expansion, additional operating costs will likely be required to support any new facility or facilities.

An additional challenge to the General Fund's long term fiscal health is the unfunded capital and infrastructure projects that were identified during the FY 2005/2006 budget process. A full inventory of the City's unfunded projects over a twenty-year planning period was developed, totaling \$433 million. Of particular concern is the unfunded Civic Center project which anticipates the need to reconstruct or renovate the existing City Hall complex due to functional obsolescence and significant maintenance and repair costs.

Finally, the future of the now closed Sunnyvale Town Center Mall will have a major impact on the health of the General Fund and the Redevelopment Agency Fund. At the current time the City has a Disposition, Development, and Owner Participation Agreement (DDOPA) with the Fourth Quarter Properties to completely rebuild and expand the shopping center. The developer has fallen behind the time frames specified in the DDOPA for undertaking the project, and the City is exploring options for curing the default or identifying alternative ways of accomplishing the revitalization of this core element of the downtown. Besides significantly impacting the Sales Tax revenue of the General Fund, a delay in this project also has a very detrimental effect on Property Tax Increment received by the Sunnyvale Redevelopment Agency. Since the Redevelopment Agency's revenues are dedicated to debt service and repayment of a General Fund Loan, any decrease in Property Tax Increment will ultimately reduce repayment to the General Fund and therefore resources available to fund basic City services.

General Fund Reserves and Set-Asides

The City has established reserves in the General Fund that are restricted by prior policy or legal requirements to specific uses. The reserves and set-asides contained in the General Fund's Long Term Financial Plan play a pivotal role in the City's multi-year planning strategy. The General Fund currently has four reserves.

The first is the Contingencies Reserve equal to 20% of the operating budget each year. This reserve is to be used only in case of emergency or disaster, and is not intended for normal unanticipated expenditures. In the previous Fiscal

Sub-element prepared in 1988, the policy called for this reserve to be 10% of operations, but Council policy adopted in FY 1992/1993 changed it to 20% of operations. This reserve changes each year as operations of the General Fund either increase or decrease.

A second reserve in the General Fund is entitled the 20-Year Resource Allocation Plan (RAP) Reserve. This reserve functions to level economic cycles from year to year. By letting this reserve vary each year, the fund can absorb the cyclical effects of the economy and specifically plan for project-related expenditures. In essence, this reserve grows during periods of economic growth and is drawn down during the low points of economic cycles to maintain stable service levels. The 20-Year RAP Reserve functions very effectively to prevent the City from adding services at the top of the economic cycle that cannot be sustained while allowing it to maintain Council-approved services levels during economic downturns.

The function of the 20-Year RAP Reserve and its strength has been particularly apparent when the City struggled with the rapid economic downturn resulting from the dot.com bust. In prior years when the City was experiencing strong economic growth, the reserve was building up over time to the \$61 million level reached in FY 2002/2003. Then, as the effects of the economic downturn began to be fully felt, the reserve was available to provide a “cushion” to maintain City services at desired levels. This reserve has been drawn down since FY 2003/2004 and current projections are that it will be used until FY 2011/2012 when it will gradually begin increasing as revenues equal or exceed expenditures.

The third reserve in the General Fund is the Reserve for Capital Improvement Projects. Originally entitled the Land Acquisition Reserve, it was established in FY 1994/1995 for the purpose of purchasing land or property in the downtown area with an emphasis on future income generation through economic development. In the past, it was used to purchase key parcels in the downtown area. As the title change indicates, its purpose has now been expanded to provide funds for one-time capital improvement projects. The reserve increases throughout the Long Term Financial Plan whenever the City’s land assets are sold.

Finally, from time to time it is necessary to establish various additional reserves for specific purposes as required by contracts or grants. In prior years the General Fund also has had an additional 5% of operating costs in the Service Level Stabilization Reserve. This reserve was established in FY 1993/1994 to provide funds for increased service levels or costs in excess of inflation. Before FY 1993/1994, the Resource Allocation Plan contained an on-going set-aside called the “One Percent of Operations Set-aside” that provided the ability to handle revenues that did not perform as well as projected and expenditures that

increased more than inflation. This set-aside was replaced by the Service Level Stabilization Reserve.

In the Adopted FY 2005/2006 Budget the Service Level Stabilization Reserve was removed from the General Fund Long Term Financial Plan. This reserve was replaced by the Service Level Set-Aside. This set-aside represents funds that are available to increase service levels or add new services on an ongoing basis. The Service Level Set-Aside was established at \$500,000 increasing with inflation each year. It is important to note that, once identified for ongoing purposes, the funds are transferred to the appropriate program and the Set-Aside is reduced accordingly in the Long Term Financial Plan.

Another reserve that the General Fund has had in the past is the Non-Recurring Events Reserve. This reserve contained funds from FY 1997/1998 and FY 1998/1999 that resulted from greater than anticipated revenues and lesser than anticipated expenditures during the height of the dot.com boom. By Council action, these types of one-time funds resulting from the peak of the economic cycle were set aside and used for significant high-priority capital and special projects and not used to add recurring services. This reserve was substantially spent down following construction of the Senior Center and was eliminated in the Adopted FY 2005/2006 Budget.

In past years the General Fund Long Term Financial Plan contained a planned expenditure called Fiscal Uncertainties. The Fiscal Uncertainties line item was contained within the Expenditures section of the financial plan, and it represented the on-going latitude that was available to increase service levels, add new annual programs, or address unexpected fiscal pressures. For the recommended FY 2004/2005 Budget the Fiscal Uncertainties line item was zeroed out for the first nine years of the plan and in the recommended FY 2005/2006 Budget this line item was eliminated. This line item has been replaced by the Service Level Set-Aside, which provides flexibility to add services while maintaining existing service levels.

UTILITY FUNDS

The City's Utility Funds incorporate programs and activities that are fully self-supporting by way of user charges and fees. As a matter of local policy, no tax funds from the General Fund are used to support Utility activities. Likewise, no utility funds are used to support non-related General City activities.

The City has three utility funds: the Water Supply and Distribution Fund, Solid Waste Management Fund, and Wastewater Management Fund. Additionally, the SMaRT Station[®] Fund has been established to account for operations at the Sunnyvale Materials Recovery and Transfer Station, which is a partnership among the three cities of Sunnyvale, Mountain View and Palo Alto.

Utility user charges and fees are established at a level necessary to pay all costs. The rate and fee structure for each Utility fund is dependent on expenditure requirements. Review of the utility rates is conducted each year to ensure that they are sufficient to pay all costs while also avoiding major "spikes" in the rate structure. Sunnyvale residents typically enjoy utility rates that are 25% lower than the average of surrounding communities. Commercial customers also enjoy rates that are competitive with surrounding communities.

In late July 2006, the California Supreme Court decided the Bighorn-Desert View Water Agency case which will have a substantial impact on rate setting for the utilities going forward. The Supreme Court held for the first time that water service rates are subject to certain requirements of Proposition 218, an initiative Constitutional amendment passed in 1996 that placed restrictions on local revenue raising authority. While the Court's ruling only specifically covered water rates, legal opinion is that the reasoning would also apply to sewer rates and government provided refuse collection rates. In summary, the Bighorn ruling will now require that local governments comply with the notice and majority protest proceedings of Proposition 218. In addition, revenues from water, sewer, and refuse service charges will be governed by Proposition 218 rules, which generally require that rates not exceed the cost of providing the service. Finally, the case also held that all property related fees, including the utility service charges, may be reduced or repealed by initiative. A number of questions raised by the Bighorn ruling are still unanswered. In the interim, the City will proceed to set rates in accordance with Proposition 218 requirements. The primary effect of this change will result in additional expense and delay of the rate setting process.

Especially important to the Water and Wastewater Funds is the issue of system repair and replacement. A method has been established to provide resources for the ongoing repair, replacement, and rehabilitation as part of the user rates. A utility's duty to serve outlasts the life of its existing infrastructure, and utility services provided today are using up capital resources which must be replaced to serve future customers. At a minimum, utilities should target to fund depreciation each year. This means that rates are set at a level at which

revenues not only cover all obligations of the utility, but also the annual depreciation expense. This depreciation expense should be set aside as cash in a reserve to be drawn upon for capital needs. The reserve is not intended to entirely cash fund all future repairs and replacements, but instead to serve as a sinking fund which helps to keep rates from spiking during periods of high capital needs. Other sources such as current rates and bonded indebtedness also will be needed to provide funds for the total capital requirements.

Water Supply and Distribution Fund

The Water Supply and Distribution Fund accounts for all revenues and expenses related to the City-operated water utility. Purchased water is by far the largest expenditure within the Fund, accounting for about 70% of direct operating costs.

Sunnyvale receives water from four different sources. The City purchases the majority of its water from two wholesalers: the San Francisco Public Utilities Commission (SFPUC), and the Santa Clara Valley Water District (SCVWD). The amount purchased from each depends upon the price per acre foot and minimums required by each contract. The City also pumps ground water from City wells, for which Sunnyvale is charged a pump tax from the SCVWD. Finally, the City's Water Pollution Control Plant provides recycled water as part of the Water Reclamation Project begun in 1993. For FY 2006/2007, approximately 41% of the City's water is projected to come from SFPUC, 45% from SCVWD, with 7% each from wells and recycled water.

Recycled water currently provides landscaping water for various facilities located in the northern third of the City. The cost for recycled water is borne by both the Water Supply and Distribution Fund and the Wastewater Management Fund. The City is currently reviewing the costs and benefits of producing recycled water to determine whether to expand the program in other areas of the City.

The remaining direct operating costs within the Water Supply and Distribution Fund are related to City activities involved in operating and maintaining a water supply and distribution system. The system includes ten storage reservoirs and approximately 280 miles of transmission and distribution mains. Other activities include management of the wholesale water contracts, effective utilization of conservation programs, recycled water and City-owned wells, and meeting all water quality and health standards.

Revenues consist primarily of water rates, which must be set to maintain the fund in a sustainable financial position. Water rates are set through the use of a Twenty Year Water Production Forecast. This analysis examines the total amount of water that will be needed for the next twenty years, taking into account demand trends, water conservation, growth and projections of population. Projections from each of the City's water wholesalers for the next year and longer term are another important factor for the City's water production forecast. The

fact that Sunnyvale utilizes long-range financial planning and sets utility rates every year helps to minimize rate swings to customers. The use of a twenty-year water production forecast also allows us to identify which water source will be the most cost-effective each year and purchase accordingly.

Two major issues will continue to affect the financial health of the Water Supply and Distribution Fund over the near and longer term. These are substantial increases that have been projected by City wholesalers for purchased water, and the state of the Water Fund infrastructure.

As indicated earlier, the City obtains wholesale water from the SFPUC Hetch Hetchy system, and the Santa Clara Valley Water District. Costs for purchased water have been relatively stable from the SCVWD, and are projected to be in the neighborhood of three to five percent over the foreseeable future. However, projections from the SFPUC have not been reliable and the rates have experienced wild swings from year to year. Recent projections indicate that rates will be substantially higher over the next ten years, with annual increases ranging from 6.5% to a high of 17%. These large increases are due primarily to the impact of the Hetch Hetchy \$4 billion Water System Improvement Program. The net effect of the SFPUC increases will be water rate increases for Sunnyvale users that are higher than projected inflation over the next decade.

The second factor that will significantly impact the Water Fund over the next twenty-year planning period is infrastructure maintenance. The Water Supply and Distribution Fund has a large number of varied assets, including water mains, pumps, tanks, valves, and reservoirs. The Public Works Department has prepared a Long Range Infrastructure Plan which identifies and inventories these assets and the costs and schedules are currently being refined. Depending upon assumptions regarding useful life, conditions, and costs for repair, the infrastructure projects may require additional capital to maintain the system in optimum working order.

Wastewater Management Fund

The Wastewater Management Fund accounts for the revenues and expenses related to the City-operated sewer collection and Water Pollution Control Plant (WPCP) services.

The City owns and operates an extensive system for management of wastewater (sewage) within City limits and in a small area in northern Cupertino. The system includes approximately 327 miles of sewer pipes and a 29.5 million gallon per day (MGD) Grade V Water Pollution Control Plant. Unlike other plants in our area, which serve multiple jurisdictions, the Sunnyvale WPCP serves principally one City. Operations include the transport of sewage to the treatment plant, wastewater treatment, recycled water production, and industrial discharge inspection and enforcement. The WPCP also operates a Power Generation

Facility (PGF), which generates electricity for the Plant using natural gas that is a byproduct of the landfill and digester operations. The PGF was constructed in 1997 and replaced the need for purchasing power from PG&E to operate the WPCP.

Infrastructure maintenance and replacement has been and remains the largest issue for the Wastewater Management Fund. Portions of the treatment plant and collection system are approaching 50 years in age and are deteriorating. Optimal capacity is an important issue in developing the rehabilitation and replacement plan for the Plant. Although the WPCP has a 29.5 MGD capacity, it is currently processing about 15 MGD. Possible alternatives are to downsize, and/or to make some of this capacity available to other nearby jurisdictions to help defray overhead and provide additional revenue to this fund. As with the Water Fund, the Public Works Department is finalizing a Long Range Infrastructure Plan for Wastewater facilities which may require additional capital to fund.

Environmental regulations continue to restrict numerous pollutants, requiring additional study and increased public outreach efforts to reduce the amount of pollutants reaching the San Francisco Bay. Conforming to these regulations poses a substantial cost to the Wastewater Management Fund.

Solid Waste Management Fund

The Solid Waste Management Fund accounts for the revenues and expenses related to collection, recycling, and disposal of solid waste generated within the City of Sunnyvale. A private company, Bay Counties Waste Services, doing business in Sunnyvale as Specialty Solid Waste & Recycling ("Specialty"), has been issued an exclusive franchise for collection of all refuse and recyclable materials. Specialty is paid monthly, with payment based on actual expenses from the prior year adjusted by various indexes as identified in the contract. One major factor affecting the contractor payment is the cost of fuel. Currently, payments are up due to higher than anticipated increases in fuel costs.

Other refuse services are provided by City staff, including maintenance of a closed landfill and source reduction education.

The City of Sunnyvale is party to a Memorandum of Understanding (MOU) with the cities of Palo Alto and Mountain View for the operation of the Sunnyvale Materials Recovery and Transfer (SMaRT) Station, a recycling and solid waste transfer facility. (see discussion in following section.)

Sunnyvale and Mountain View are required to deliver all of their garbage and residential recyclables, including yard trimmings, to SMaRT. Palo Alto continues to operate its own landfill, and facilities for yard trimmings and compost and recycling, and therefore is required to deliver only specific amounts of garbage that vary from year to year. Operations of the Sunnyvale Materials Recovery and

Transfer Station and disposal of refuse at the Kirby Canyon Landfill are included in the SMaRT Fund, but the City's share of these activities is reflected in the Solid Waste Management Fund. The projected cost increases for the SMaRT Station have a definite impact on the fiscal condition of the Solid Waste Management Fund, as discussed below. Currently Sunnyvale's share of SMaRT expenses is 47%, with Mountain View paying 29% and Palo Alto paying 24%.

Sunnyvale's refuse operation continues to meet and exceed the requirements of AB 939, legislation passed in 1989 that mandated a reduction in waste going to the landfill of 50%. The City has met this goal since 1996.

Sunnyvale Materials Recovery and Transfer (SMaRT) Station Fund

The Sunnyvale Materials Recovery and Transfer Station Fund accounts for operations at the SMaRT Station and receives its revenue from charges to the cities of Sunnyvale (Solid Waste Management Fund), Mountain View, and Palo Alto. Major operating cost components include the contract with Green Team/Zanker, the SMaRT Station operator, and disposal fees and taxes collected by the Kirby Canyon Landfill. The fund is designed so that annual revenues and expenditures are in balance and that no fund balance is carried forward to the next year.

Operating costs and revenues from the sale of recyclables are charged to or distributed to the cities based on the numbers of tons of solid waste each community brings to the SMaRT Station for materials recovery, transfer, and disposal. Palo Alto's recent adoption of a "Zero Waste" policy, setting a goal of diverting 90% of that City's waste, will impact the contribution level of each agency. The anticipated effect of this policy is to decrease significantly the number of tons projected to be brought to the SMaRT Station by Palo Alto. This in turn increases the projected expenses of Sunnyvale and Mountain View.

The SMaRT Station Replacement Sub-fund provides for the replacement of City-owned SMaRT Station equipment. The three participating cities contribute to these replacement efforts and to payment of debt service for original construction of the facility based on fixed percentages established by the SMaRT Station Memorandum of Understanding (MOU) among the cities. Sunnyvale's share of equipment replacement costs is 55.28%.

One issue that continues to have a significant fiscal impact on the SMaRT Station is the service provider. The current contract with Green/Team Zanker expires at the end of 2007. Wage and benefit levels of various SMaRT workers continue to be at issue, and could add significant operating costs in the future. However, the bidding process often results in more favorable pricing through competition and so the effect of these two elements is difficult to project.

COMMUNITY RECREATION FUND

The Community Recreation Fund, which was created in FY 1991/1992, contains the recreation activities of the City, including the two City-operated golf courses, club house, and pro shop, the tennis center, and recreation classes and services. Prior to the initiation of the Fund, recreation services were part of the General Fund. The creation of the Community Recreation Fund included the merger of the City's golf and Tennis Center operations with the remainder of all other recreation service activities, as well as the adoption of new, entrepreneurial approaches to service delivery. Because of the establishment of this enterprise fund, the General Fund subsidy has been significantly reduced from what would have been required for recreation services going forward if this action was not taken.

The FY 2006/2007 Budget currently provides roughly \$12 million worth of diverse recreation programs and services to the community with a total subsidy from the General Fund of approximately \$3.9 million. Around \$1 million of this subsidy is returned to the General Fund to cover administrative in-lieu costs, making the net subsidy \$2.9 million. The remaining cost of recreation programming is paid primarily by the direct beneficiaries of the programs in the form of user fees.

When the Community Recreation Fund was established, the General Fund subsidy was approximately \$2 million, with \$91,000 returned to the General Fund for in-lieu charges. When converted to today's dollars, the same level of subsidy would be approximately \$3 million, and the in-lieu charges would be \$142,000, for a net subsidy of \$2.9 million. As this information indicates, over the intervening years the subsidy has held constant in spite of the fact that the service level approved by the Council has increased. In many cases, the required increase in expenditures has occurred with no corresponding increase in General Fund subsidy.

In FY 2006/2007, the Budget was realigned to reflect true expenses and revenues of the Community Recreation Fund and the General Fund subsidy was adjusted accordingly. In future years, the Community Recreation Fund will be required to cover all cost increases related to operating the enterprise. The only exception will be for new services approved by Council, which will receive funding through a corresponding increase in the General Fund subsidy. The Community Recreation Fund will also retain any fund balance generated from cost savings, revenue initiatives, etc. to assist in keeping service levels stable during slower economic periods.

Golf operations are the greatest single source of revenue for this Fund. The City operates one 18-hole and one 9-hole course. There are continuing challenges ahead as more golf courses have been added in the area along with high-end courses that continue to compete for Sunnyvale customers. Golfers are becoming more discerning and demanding, looking for the best value for their

dollar. Many will prefer a more “full service” facility than the amenities offered at Sunnyvale’s courses. Council’s continued support of market-based golf fees regardless of residency or age (with the exception of monthly discounts for residents, seniors, youth and disabled golfers) is a critical factor in maintaining this important revenue stream.

Sunnyvale maintains a fee waiver program that is an important component of the City’s delivery of recreation services. It allows the economically disadvantaged to participate in programs by defraying the established user fees. Beginning in July of 2007, the program will be limited to those economically disadvantaged residents who are 17 years of age or younger for City-offered recreation programs.

The Community Recreation Fund contains two reserves. The first, Cooperative Sports Reserve, reflects requirements of a contract that the City has with the Sunnyvale School District to administer the after school intra-mural sport league programs at Sunnyvale Middle School and Columbia Middle School. The reserve carries over funds for the Sunnyvale Middle School program, which generally brings in more revenue from participant fees than is needed to cover direct program costs. The reserve funds are used to purchase equipment and uniforms as needed by the school.

The second reserve is the Twenty-year Resource Allocation Plan (RAP) Reserve, which functions here as in other funds, to levelize expenses and revenues over the planning period. These funds will be drawn down to maintain existing service levels in upcoming years. The Fund is allowed to keep any revenues above projections and savings from service level efficiencies in a given year to help stabilize economic cycles and maintain service levels.

CAPITAL PROJECTS FUNDS

Capital Projects Funds are used for major capital acquisition, construction activities, and renovation or replacement of General City fixed assets. They are established to separate out funds and expenses for capital improvement projects, which are typically longer-term than operations and often span more than one fiscal year. The City currently operates two of these funds: the Capital Projects Fund and the Infrastructure Renovation and Replacement Fund. Capital and Infrastructure projects related to the Utility Enterprise Funds are budgeted and accounted for within each individual utility fund.

The Capital Projects Fund was established in FY 1997/1998 to account for all capital projects that are funded by the General Fund and other governmental funds or that are funded by multiple sources. The Capital Projects Fund is divided into distinct sub-funds that receive direct transfers from the funds that are responsible for the particular projects. There are currently four sub-funds of the Capital Projects Fund: the General Sub-fund, the Gas Tax Sub-fund, the Traffic Mitigation Sub-fund, and the Traffic Impact Sub-fund. Each sub-fund records revenues, interest earnings, transfers and expenses separately.

All utility projects are completely budgeted and accounted for within each Utility Enterprise Fund with the exception of those that are funded in part by other governmental funds.

The Infrastructure Renovation and Replacement Fund was established in FY 1996/1997 to provide a long-term funding mechanism for repair and replacement of the City's general infrastructure assets such as buildings, streets, and parks. Similar to the Capital Projects Fund, this fund is divided into distinct sub-funds that receive direct transfers from the funds that are responsible for the particular infrastructure projects. Each sub-fund records revenues, interest earnings, transfers and expenses separately. Currently the sub-funds are General, Community Recreation, and Multi-funded Assets. Infrastructure projects for the City's three utilities are budgeted and accounted for in each utility fund in accordance with governmental accounting principles.

An issue for both the Capital Projects Fund and the Infrastructure Renovation and Replacement Fund is that over the next twenty years capital needs are projected to exceed resources. For example, over \$400 million in unfunded projects have been identified in the FY 2006/2007 budget.

SPECIAL REVENUE FUNDS

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. The City currently maintains ten Special Revenue Funds, some with Sub-Funds to account for certain revenue sources as required by law.

Housing Fund

The Housing Fund is comprised primarily of revenues from federal HOME grants, housing mitigation funds, and Below-Market-Rate ("BMR") receipts.

Expenditures are for operating activities related to developing affordable housing and managing the City's below-market-rate housing program and for capital and special projects targeted to achieve the goals of the City's Housing and Community Revitalization Sub-Element of the General Plan and the Consolidated Plan required by the United States Department of Housing and Urban Development (HUD) in order to be eligible for Community Development Block Grant (CDBG) and HOME funds. The Housing Fund has three sub-funds.

The first, the Housing Mitigation Sub-Fund, accounts for Housing Mitigation fees which are paid by high-intensity industrial developers to mitigate development impacts on the City's jobs/housing balance. These funds are used to support the provision of affordable housing within the City.

HOME funds are maintained in a second sub-fund of the Housing Fund. In general, HOME grants from the federal government may be used to fund provision of affordable housing units. Eligible activities for HOME grant funds include: acquisition, new construction, rehabilitation and down payment assistance. The activities must benefit low and moderate income households, at or below 80% of area median income.

Finally, the Housing Fund has a third sub-fund that contains Below-Market-Rate (BMR) and other grant-supported housing activities. Revenues in this sub-fund include BMR processing fees, housing loan repayments, revenues from BMR code violations, and interest earnings. Expenditures are operating costs associated with maintenance and monitoring of the BMR program and special projects related to the provision of the BMR program.

At the present time, the various Housing funds, along with the Community Development Block Grant Fund, have a substantial fund balance available for the provision of low and moderate income housing in Sunnyvale. The challenge faced by the City is to develop or identify eligible projects in the context of the area's high property value and rising construction costs. Under current projections, a substantial amount of Low and Moderate Income Housing funds will become available from the Sunnyvale Redevelopment Agency during the latter part of the decade. When these resources come on line, this challenge will intensify and new approaches will need to be developed in order to provide the affordable housing needed.

Community Development Block Grant (CDBG) Fund

The Community Development Block Grant Fund consists of two sub-funds which account for revenues from federal Community Development Block Grants and the repayment of commercial and residential loans. Primary expenditures are for operations, housing opportunities, special projects, and most of the City's outside group funding efforts.

The Community Development Block Grant sub-fund accounts for Community Development Block Grants from the federal government. Traditionally, CDBG funds are used primarily to address the City's affordable housing strategy. This includes support of housing agencies; rehabilitation and retrofitting of the existing housing stock; and the acquisition, rehabilitation, and construction of affordable housing by non-profit developers. As in the Housing Fund, capital and special projects are targeted to achieve the goals of the City's Housing and Community Revitalization Sub-Element of the General Plan and the five-year Consolidated Plan. Additionally, by regulation, up to 15% of the annual CDBG allocation plus prior year program income may be used for human services and public service programs. CDBG funds may also be used for projects that benefit groups with special needs such as senior and handicapped citizens or for targeted geographical areas that meet certain income requirements.

The CDBG Revolving Loan Sub-fund was established by Council action in 2001 and separated for accounting purposes in FY 2003/2004. This revolving fund was created to provide a practical budgetary management tool to deal with program income from housing loans made with CDBG funds and to provide greater flexibility in the management of the City's housing assistance programs. The Revolving Loan Sub-fund has one source of revenue, housing loan repayments.

Over the last several years the amount of CDBG monies appropriated to local agencies by the federal government has been substantially decreasing. Additionally, several attempts have been made at the federal level to eliminate this program. While it is currently still viable, it may be in jeopardy in future years and the City will need to look to its other resources to accomplish the housing and human services strategies identified.

Park Dedication Fund

The Park Dedication Fund was established to meet statutory requirements regarding the accounting for park dedication monies. In general, the City collects park in-lieu fees for multi-family residential projects that do not dedicate land for use as parks or open space. The money collected from these fees is to be used to provide park or recreational facilities. This fee is now calculated on an average fair market value per square foot as determined by the Community Development Department annually. These revenues are recognized in the Park Dedication

Fund, and then available resources are appropriated here or transferred to the Capital Projects Funds for designated and approved park-related projects. Revenues in this Fund also include rental income from certain houses that the City purchased with Park Dedication Funds in anticipation of park expansion projects.

The City has enjoyed a housing construction boom in recent years which has resulted in substantial Park Dedication fees paid. These funds have been utilized for several important capital projects as well as to support rehabilitation of existing park facilities. It is expected that these funds will taper off with the current housing slowdown, but continue at a modified level into the future.

Asset Forfeiture Fund

The Asset Forfeiture Fund was established to account for monies received through drug and other law enforcement activities as allowed under Federal and State asset forfeiture guidelines. The Federal and State asset forfeiture laws were enacted to allow police jurisdictions the ability to seize money or property used in illegal drug activities and use the proceeds for law enforcement purposes. The purposes for which asset forfeiture can be used are limited. In general, funds can only be used to supplement existing law enforcement activities. Depending upon current conditions, funds are drawn down for new one-time expenses or equipment targeted for law enforcement services that fit into the City's priorities. Changes in state and federal laws have led to very little new money being added to the Asset Forfeiture Fund.

Police Services Augmentation Fund

The Police Services Augmentation Fund accounts for two grant programs that provide monies for law enforcement purposes. The first is the Supplemental Law Enforcement Services (SLES) program established by the State, and the second is a small Federal Local Law Enforcement Block Grant (LLEBG), also called a Justice Assistance Grant (JAG), from the Bureau of Justice Administration (BJA). The purpose of both programs when enacted was to provide additional funds to local police departments to supplement their existing operations.

The State SLES monies constitute the major portion of this fund. The City first received the SLES grant in FY 1996/1997. Over the years, the amounts of this grant have decreased significantly. Initially, the monies were used to fund a full-time Domestic Violence Investigator, a Patrol Watch Commander, and participation in a regional narcotics task force. Subsequently, Council approved the use of the funds for the Patrol Watch Commander and two Internal Affairs Investigators. Due to the continual decline of funding and sharply increasing personnel costs. By FY 2003/2004 the grants were no longer able to support the three positions. Since FY 2004/2005 the funds were only sufficient to fund the Police Watch Commander position. Should the grants reduce further or go away,

the position will be eliminated unless the City can identify another discretionary source to support it.

Employment Development Fund

The City of Sunnyvale, as administrative entity for the North Valley (NOVA) Job Training Consortium, is required by legislation and regulations to account for the use of various Federal and State funds and program revenues for the workforce development activities that are conducted for the consortium. The City has established the Employment Development Fund to fulfill this obligation.

NOVA, formed in 1983, serves the cities of Cupertino, Los Altos, Milpitas, Mountain View, Palo Alto, Santa Clara and Sunnyvale, and is administered by the Department of Employment Development of the City of Sunnyvale. NOVA has a wide variety of programs funded through various vehicles, with baseline funding originating from the Federal government and passing through the State of California. The primary funding for the Department of Employment Development/NOVA consists of federal Workforce Investment Act (WIA) appropriations. WIA funds represent about 80% of total NOVA funding.

An issue that has challenged the NOVA program over the last several years is the unpredictability of funding sources, both through the federal budget appropriation process and the allocation formulae for distribution to states. The overall federal WIA funding has declined over the past six years by 19% and the State's allocation has been reduced by 34%, with both amounts not being adjusted for the inflationary increases that have occurred. NOVA has been able to maintain a high level of service by successfully competing for numerous discretionary grants from governmental, industry and private sources.

Recognizing the likelihood of the continued trend to shift limited Federal resources to the priorities of national and homeland defense, budget deficit payments and tax reductions, the leadership at NOVA continues to explore vehicles that would increase the resources and stability of workforce investments through such means as proposing changes in statewide policy and funding priorities, forming alliances and collaborations with local public and private enterprises such as corporations and community colleges, offering services more targeted at the human resource needs of the seven cities in the consortium, and modifications to the current operating model that would reduce expenses.

Parking District Fund

The Parking District Fund accounts for assessments collected from property owners in the Downtown Parking District for the ongoing maintenance of six downtown parking lots with a total of 913 parking spaces. The Downtown Parking District includes all public parking in the downtown area with the exception of the parking provided by the Sunnyvale Town Center. Annual assessments for FY

2006/2007 ranged from \$34.03 to \$109.58 per deficit parking space, depending upon zone.

Debt previously issued to purchase land and make improvements in the District was completely paid in FY 2003/2004.

Proposition 218 had a significant effect on the assessment process. Essentially, the assessment must be approved by at least 50% of the property owners voting, with votes weighted according to benefit. In the event that voters decide not to approve assessments, other potential revenue raising possibilities such as paid parking will need to be identified.

In the near future, the various new developments now occurring or planned in the downtown area are likely to change the character of the parking assessment district. Once all of the various factors related to parking in the downtown are defined and stabilized, the Parking District may be reconfigured considerably.

Youth and Neighborhood Services Fund

The Youth and Neighborhood Services Fund accounts for the revenues and ongoing operating program expenditures associated with the management and maintenance of the Columbia Neighborhood Center ("CNC"). On May 10, 1994 Council approved development of a neighborhood service center at Columbia Middle School in partnership with Advanced Micro Devices (AMD) and the Sunnyvale School District. The mission of the CNC is to meet the health, social, recreational, and educational needs of North Sunnyvale youth through a coordinated network of services.

AMD and the City provided capital funding for the Center, which was constructed by the Sunnyvale School District. An operating agreement between the City and the Sunnyvale School District provides for the two parties to share in the cost of services at the CNC. Other revenues to the Fund include recreation fees and rental fees for CNC facilities, and interest earnings on an endowment fund. A General Fund subsidy pays for approximately 50% of the CNC annual program costs.

In FY 1996/1997 Council invested \$500,000 as an endowment for the Columbia Neighborhood Center. This was essentially the City's share of the AMD contribution of \$1 million to the CNC. When this endowment was established, it carried with it a commitment to maintain the principle to generate interest to help offset ongoing operating program expenditures. Also included in the endowment were contributions made to the City in the amount of \$6,658 on behalf of former employees. Interest earnings on the endowment accrue to the Youth and Neighborhood Services Fund.

Services provided at the CNC have been extremely well received by the

Sunnyvale community, and expansion to the facility is needed in order to accommodate increased demand. Talks are currently underway between the Sunnyvale School District and the City to identify funding for the expansion and additional services.

Redevelopment Agency Fund

The Redevelopment Agency is a governmental and legal entity separate from the City. However, the Agency is a component unit of the City for which the City is financially responsible. Due to certain agreements between the Redevelopment Agency and the City, the General Fund of the City is inextricably tied to the financial condition of the Redevelopment Agency.

In Sunnyvale, the Redevelopment Agency scope is very small as compared to those in other cities in Santa Clara County. Sunnyvale has only one project area, consisting of 184 acres in the downtown area. The City's Property Tax Increment, which equals about \$3.4 million annually, comprises 1% of the total for Santa Clara County. By contrast, the City of Milpitas has four project areas and receives 11% of the total County Property Tax Increment and Mountain View has two project areas with 8% of the total. San Jose has by far the largest Redevelopment Agency, with sixteen project areas and 59% of the total, or \$142 million.

The primary source of revenues to the Redevelopment Agency is Property Tax Increment. The other major revenue source for this fund is a lease payment from the General Fund for the Mathilda Avenue Parking Structure at the Town Center in the amount of \$1.2 million annually.

Included in current requirements are debt service payments for the Central Core Redevelopment Project Tax Allocation Bonds and the Parking Facility Certificates of Participation. At the close of FY 2004/2005 the Redevelopment Agency had two outstanding loans due to the City General Fund totaling approximately \$51.2 million. This is largely the result of the Redevelopment Agency's inability to pay debt service payments following the passage of Proposition 13. The Agency entered into a First Amended Repayment Contract with the General Fund in 1977 to repay the debt associated with initial improvements to the Project Area and its inability to make lease payments on the parking structure. This Contract is referred to as the "1977 loan." In 1986 State legislation imposed more stringent requirements on funds advanced by the General Fund to the Redevelopment Agency and a separate loan was created to account for costs subject to these restrictions. This loan is referred to as the "1986 loan."

Even with all available funds, it is anticipated the RDA will not be able to fully repay the General Fund its principal and interest by 2028 when the tax increment revenues end. At the end of the redevelopment project life, it is estimated that

the 1977 Loan will be paid off and the balance on the 1986 loan will be approximately \$167 million.

The Redevelopment Agency is currently unable to make payments of 20% of its tax increment revenues to the Low and Moderate Income Housing Fund because of preexisting debt obligations. Each year, the Agency calculates the contribution that should have been made and books it as a liability in its financial statements. It is currently estimated that when the tax increment cap is reached the liability will total approximately \$24.4 million. State law allows the Agency to continue collecting tax increment after the Project time and increment limits are reached to fund its housing liability. Repayments of the Housing liability are anticipated to begin in FY 2028/2029. An actual deposit to the RDA Low and Moderate Income Housing Fund will also be required when the 1977 General Fund loan is paid off as estimated in FY 2017/2018.

Since the inception of the Redevelopment Project, the State has enacted several laws that placed revenue restrictions on redevelopment agencies. These include capping the time period for collection of tax increment for each redevelopment project area. The original termination date was November 2025. In FY 2004/2005, the plan was extended by one year in compensation RDA Property Tax transferred to the State Educational Revenue Augmentation Fund (ERAF) in FY 2003/2004. The plan was extended for another two years in FY 2005/2006 for compensation of the RDA's ERAF payments made in FY 2004/2005 and FY 2005/2006. For Sunnyvale's project area, the termination date is now November 2028.

More important was the establishment of revenue limits for redevelopment agencies, referred to as Property Tax increment caps. The revenue limit/increment cap for the Sunnyvale Redevelopment Agency as originally established was \$118 million. In FY 2005/2006 the Agency amended its Redevelopment Plan to increase the tax increment cap to \$600 million.

Recently, attempts have been made through legislation or voter-approved initiative to curb other powers of redevelopment agencies. The issue of the eminent domain power of redevelopment agencies has received a great deal of attention because of perceived abuses in other states. This has led to State Proposition 90 which is slated for the November 2006 ballot. Proposition 90 is an initiative Constitutional amendment that would limit state and local government authority to take ownership of private property by prohibiting the use of eminent domain unless the property acquired is to be owned and occupied by a governmental agency. The proposition would also require government to pay property owners for substantial economic losses resulting from certain new laws and rules passed to benefit overall public health, safety and welfare.

If passed, the eminent domain aspects of Proposition 90 would probably have little effect on the City because the Agency has no current plans to use eminent

domain to acquire land for redevelopment purposes. However, the other aspects of Proposition 90 could pose serious financial risks in terms of potential claims and lawsuits from property owners who allege property values have been diminished due to governmental actions such as rezoning, capital improvements, environmental considerations, and so on. While proponents of the measure argue that eminent domain reform is necessary to curb unwarranted government taking of private land without proper compensation, opponents maintain that Proposition 90 goes well beyond this concept by redefining "just compensation," greatly increasing the costs of government acquisition of land for such needed infrastructure improvements as schools, parks, roads, levees and other public works. Opponents further argue that passage of Proposition 90 will result in frivolous lawsuits by developers, speculative landowners and other businesses who may claim that enactment of state and local laws will impact the value of their property. A similar measure was recently passed in Oregon that has already resulted in more than 2,200 such claims seeking over \$5 billion in payments that taxpayers could ultimately have to pay.

Other Special Revenue Funds

Special Revenue Funds include various other small funds which have been established to account for specific grants as required by law. For example, the Transportation Development Act Fund is currently maintained for the purpose of accounting for funds received from the State of California for pedestrian and bicycle projects. Funds from voter initiatives in Santa Clara County designated for road improvements were established to segregate the proceeds until they were spent. The City's policy is to maintain such funds as necessary to comply with law and fiduciary responsibility.

INTERNAL SERVICE FUNDS

The City utilizes internal service funds to account for goods and services provided by one department or agency to other departments or agencies of the City. Two internal service funds, the General Services Fund and the Employee Benefits and Insurance Fund, each operate on a cost reimbursement basis. Sunnyvale's full cost accounting methodology results in all of the costs within these funds being charged back to user activities on a rental rate or additive rate basis.

The City maintains two additional internal service funds. One of the funds accounts for activities associated with the Sunnyvale Office Center. The other, the Property and Liability Insurance Fund, was created to separately account for the costs of property and liability insurance on City facilities and activities.

Programs included in the Internal Service funds account for a significant portion of total City operations. The General Services Fund, which provides support services such as fleet, buildings, and technology to operating departments, has projected expenditures of \$22.5 million in FY 2006/2007, or roughly 11% of operations. The Employee Benefits and Insurance Fund, which manages employee costs such as retirement contributions, medical insurance, and leaves, has projected expenditures of \$52.2 million, or 25% of operations. Altogether the Internal Service funds comprise almost 37% of operating costs. Sound financial management of these activities is clearly essential. We have already begun to focus on many of these areas with a complete equipment inventory and rental rate adjustment completed in FY 2005/2006 and an optimal staffing study of the Information Technology Department initiated in FY 2006/2007. Challenges for the future include the rising cost of employee benefits such as medical insurance, the appropriate use of technology to increase efficiency, and our aging building infrastructure which requires increased maintenance.

General Services Fund

The General Services Fund provides a wide range of important support services to programs within the City. These services range from fleet, to building maintenance, to technology and communication services. Funding for these services is recovered through a rental rate structure, by which activities are charged to the benefiting program operating budget. The rental rates include not only the cost of operations, but also the cost of replacement for depreciable equipment. This assures the availability of funds to replace equipment at the most cost-effective time.

There are seven Sub-funds within the General Services Fund that recognize distinct support service functions and establish appropriate rental rates for each. The General Services Sub-funds are for the following services: Fleet, Facilities,

Technology/Applications, Sewer Equipment, Public Safety Equipment, Parks and Recreation Equipment, and Project Management.

The Fleet Services Sub-fund reflects the cost of ownership of City vehicles and equipment. A primary objective of the Sub-fund is to provide rental rates that are competitive with those offered in the private sector. The main source of funding is derived from Fleet Services rentals to other programs. The Sub-fund receives additional revenue from the sale of surplus or replaced vehicles or pieces of equipment. Requirements for the Fleet Services Sub-fund consist of equipment replacement, operations, and capital projects.

The City Facilities Services Sub-fund accounts for the cost of maintaining City facilities, furniture and building equipment. There are two primary rental rate revenue items, space rental and equipment. Facilities space rental covers the cost of maintenance and custodial services in the City's various buildings, and is based upon the total square footage of building space throughout the City, divided amongst the various City programs. The equipment rental accounts for replacement costs of furniture, carpet and blinds, and building maintenance units.

The Technology/Application Services Sub-fund reflects the cost to operate and maintain the City's technology and communications program and infrastructure. This includes technology (hardware and software), communications, and office equipment. The major current requirements of this Sub-fund deal with operation of the Technology Services Programs and equipment replacement.

The Sewer Equipment Sub-fund accounts for equipment at the Water Pollution Control Plant. Rental rates for these items are applied to the Wastewater Management Fund.

The Public Safety Equipment Sub-fund maintains all fire and police service equipment such as guns, fire hose, and fire Self-Contained Breathing Apparatus (SCBA) units. Equipment such as fleet, radio, and computer equipment, is handled through the respective General Services program. All rental rates are applied to Public Safety Programs of the General Fund exclusively.

The Parks and Recreation Equipment Sub-fund accounts for equipment such as: pool covers, theater lighting, gymnastic equipment, and theater staging equipment which is used in the provision of recreation services. Rental rates are applied to the Community Recreation Fund.

Lastly, the Project Management Sub-fund accounts for the costs and revenues of project management services provided by staff within the Department of Public Works Engineering Services Program. These services provide centralized administration of the City's Capital Improvement Program in order to ensure professional and consistent design, construction, and inspection. The staff is

reimbursed by each capital project for engineering, design and inspection activities related to that project.

Employee Benefits and Insurance Fund

The Employee Benefits and Insurance Fund provides a mechanism to cover expenditures related to pension costs, employee insurance plans, workers' compensation costs and leave time while applying the principles of full cost accounting. This is accomplished by charging an additive rate to staff salaries wherever personnel hours are budgeted and expended.

To track and analyze expenditures, the Fund is separated into four Sub-funds: Leaves Benefits; Retirement Benefits; Workers' Compensation and Insurance; and Other Benefits.

The Leaves Benefit Sub-fund accounts for leave time for City employees such as vacation, holiday pay, sick time, and paid time off. Earned but unused leaves are accrued at year end in order to reflect the full cost of programs.

The Retirement Benefits Sub-fund contains the costs for the City's retirement plan. Sunnyvale contributes to two California Public Employees Retirement System (CalPERS) plans for and on behalf of its employees: Safety (3% @ 50 Plan) and Miscellaneous (2% @ 55 Plan). The City pays the employee contribution as well as the employer contribution for these plans. While the employee contribution rate is set by law, the employer contribution rate is adjusted by CalPERS through an actuarial analysis and is impacted by its investment portfolio. CalPERS employer contribution rates have experienced sharp increases over the last several years as the retirement system suffered unprecedented investment losses.

Currently the employer contribution rates have stabilized and appear to have decreased slightly. However, this is due to changes in actuarial methodology at CalPERS. Beginning for the rates effective in FY 2006/2007 CalPERS has adopted a standard 30-year rolling amortization basis for unfunded liabilities. This new basis decreases rates but creates a negative amortization of the unfunded actuarial liability so that it never is paid off but actually grows over time. In contrast, the previous method would pay off the unfunded actuarial liability at the end of twenty years. In order to avoid negative amortization, we requested that CalPERS give us contribution rates for FY 2006/2007 such that the liabilities would not increase, and we used these rates for the current budget. Understanding CalPERS methodologies and making sound financial decisions regarding pension contributions will be important for the foreseeable future.

As negotiated in the current Memorandum of Understanding with the Sunnyvale Employees Association (SEA) and the Service Employees International Union (SEIU) the Miscellaneous Plan will be enhanced from 2% @ 55 to 2.7% @ 55

effective July 1, 2007 if approved by the miscellaneous members. CalPERS current estimates that the employer contribution rate will increase by approximately 6% as a result of this enhancement. To pay for these costs, employees took no salary increase for FY 2004/2005 and agreed to a revised salary formula which was cost neutral with the retirement enhancement. The resulting salary savings have been transferred to an Enhanced Retirement Reserve in the Retirement Benefits Sub-fund. In addition, a PERS Rate Uncertainty Reserve has been created that will provide a cushion to deal with some of the volatility in PERS rates that the City has recently experienced.

The Workers' Compensation Sub-fund accounts for all costs related to Workers' Compensation benefits and is funded through a variable additive rate depending upon the classification of the employee. In this methodology, higher risk employees are charged more than low risk administrative positions. A reserve has been established in the Worker's Compensation Sub-fund to provide for claims that have not yet been paid. This reserve amount is based on an actuarial analysis. Based on the current analysis, the reserve has been established at \$10.1 million.

The Insurance and Other Benefits Sub-fund includes costs for all the employee insurance plans including medical, dental, vision and life insurance. The largest cost component in this Program is medical insurance for City employees, in particular the increasing costs of health premiums for both active and retired employees. The City has experienced rate increases in the high double digits over the last several years and expects to receive increases substantially above inflation for the foreseeable future.

The Insurance and Other Benefits Sub-fund has two reserves. The Estimated Actuarial Retiree Medical Reserve accounts for the estimated liability for the City's retiree medical costs. Based on an actuarial study conducted in 2003, the liability was calculated to be 8.6% of total payroll. A new actuarial study is being conducted in FY 2006/2007, which will provide a more accurate calculation of our liability. The second reserve, Insurance Rate Uncertainty, provides funds for several uncertainties including: unanticipated changes in premium costs, adjustments in the City's contribution costs, increases in the number of retirees beyond what has been estimated in the financial plan, and adjustments to the City's liability for retiree medical costs.

In 2004 the Governmental Accounting Standards Board (GASB) issued Statement No. 45 regarding the accounting and reporting by employers for post employment benefits such as retiree medical costs. The City will begin implementing this statement for FY 2007/2008. GASB 45 requires that we disclose our liability for retiree medical costs in our financial statements. Currently, the City uses a pay-as-you go method for funding these costs and our twenty-year budget includes full projections for retiree medical payments. In order to prepare for the implementation of GASB 45, the City is obtaining an

actuarial study to determine our liability on the new basis. Decisions will need to be made as to whether to continue to pay-as-you-go or participate in pre-funding these costs through a trust, similar to the manner in which retirement costs are handled.

On the national, state, and local levels employee benefits costs have experienced sharp increases in recent years, primarily in retirement and medical premium costs. Uncertainty in the long term contribution rates for retirement, continued high increases in medical premiums, and growing retiree medical costs are some of the significant factors that are problematic for the long term financial picture. Staff efforts to contain medical costs for active employees, and particularly retirees in future years will be critical to maintaining the City's strong fiscal position.

Liability and Property Insurance Fund

This fund was established to account for liability and property insurance costs and for claims against the City. Separating these costs from the Employee Benefits and Insurance Fund into a separate fund provides better accountability of expenditures and allows the City to recover costs based on usage rather than on salary expenditures. Currently, the City participates in a risk pool administered by the California Joint Powers Risk Management Authority.

The reserve level in this Fund is set at amounts established by actuarial studies or staff analysis. Large one-time liability claims adversely impact the reserve amount, in which case transfers are budgeted to build the reserve back over several years.

Sunnyvale has received an average of 159 claims per year over the last seven years for damage caused by city activities; the average amount paid per claim during that same time frame was \$1,800. According to an actuarial analysis done by the California Joint Powers Risk Management Agency (CJPRMA), which manages the City's risk pool, the range of average claims for jurisdictions our size is 160 to 240, with the range for claims paid at \$5,500 to \$9,000. Sunnyvale's lower than average experience in this area means that fewer scarce resources are spent on liability issues.

Sunnyvale Office Center Fund

This fund accounts for the activities of the Sunnyvale Office Center located at 505 W. Olive Avenue, across from the main City Hall. The Sunnyvale Office Center was purchased in April 2001 by the issuance of variable rate Certificates of Participation ("COPs") in the amount of \$17 million to provide expansion opportunities for the Civic Center Complex. Activities included in this fund are maintenance and operations of the office facility, capital projects, and debt service. Revenues to this fund consist of rental from outside tenants and City operations, and interest on reserves.

Currently the City is planning to keep the Sunnyvale Office Center as additional space for City programs into the foreseeable future. However, one of the issues to be reviewed in the coming years is the adequacy of existing City administrative facilities in the Civic Center complex. The future of the Sunnyvale Office Center buildings may be impacted by the results of this study.

City's Revenue Base

The structure of the City's revenue sources has a major influence on the City's ability to maintain and expand services. The structure and source of City revenue also are very important to the City's ability to withstand economic downturns. If possible, it is prudent for a city to have a variety of revenue sources since each individual revenue source reacts differently to economic conditions. It is also prudent to minimize the earmarking of general tax revenues to allow the greatest possible flexibility in addressing changing service needs.

The two major categories of revenues received by government are taxes and user fees. In 1978 Proposition 13 created a distinction between "general" and "special" taxes. A general tax is any tax imposed for general governmental purposes, while special taxes are collected or earmarked for a specific purpose or program. Restrictions on the establishment, extension, or increase of any tax were also imposed by Proposition 13 and Proposition 218 which was passed later in 1996. A majority vote of the electorate is required to change a general tax, and a two-thirds vote is required for a special tax. The taxes collected by the City are primarily general taxes which are used to support general governmental purposes. The major taxes received by the City are Property Tax, Sales Tax, Utility Users Tax, Transient Occupancy Tax, Franchise Tax, and Construction Tax.

User fees, in contrast to taxes, are charges imposed for services that benefit a specific segment of the community. In Sunnyvale, user fees are set to cover the full cost of providing the service, unless the Council chooses to charge a lesser fee to fulfill a specific public purpose.

The ways that cities are financed have continued to change significantly since the original Fiscal Sub-element. The passage in 1996 of Proposition 218 which added new procedural steps for the enactment of taxes, assessment, and property-related fees, had a notable impact in this regard. In short, Proposition 218 requires majority voter approval for general taxes and two-thirds voter approval for special taxes. It also requires majority approval for benefit assessments on real property and imposes certain notice and hearing and voter approval requirements for a fee or charge that is property related. As of the writing of this Sub-element, a July 2006 California Supreme Court Case has been decided which extends the definition of property-related fees for water, wastewater, and refuse collection services. This decision will definitely add time, complexity, and expense to the utility fee setting process.

Additionally, since the original Fiscal Sub-element several State legislative actions have occurred which either reduced the City's revenue base or altered its composition. The most significant action occurred in 2004, when California voters passed Proposition 1A, a Constitutional amendment to protect local governments

from State revenue takeaways. Proposition 1A was the culmination of an historic agreement between local governments and the Governor to limit the State's ability to unilaterally shift city revenue to its General Fund.

The net result has been that Property Tax has once again become Sunnyvale's single biggest General Fund revenue source, while revenues such as the Motor Vehicle License Fee and State Subventions have decreased significantly.

While the alterations to the City's revenue base discussed above have all been permanent, a temporary change to Property Tax and Sales Tax occurred in FY 2004/2005. In response to its record budget deficit in that year, the State of California issues "Economic Recovery Bonds." These bonds were secured by a mechanism called the "Triple Flip" which swaps local Sales Tax for Property Tax on a dollar for dollar basis while the bonds are outstanding. Under the Triple Flip, $\frac{1}{4}$ cent of the local Sales Tax was reduced and given to the State, which in turn replaced the lost revenues by an equal amount of Property Tax. This mechanism was enacted in order to guarantee the bonds with "new" State Sales Tax. The exchange mechanism will be in place as long as the bonds are outstanding, which is expected to be ten years or less. Although the City's total revenues are held harmless under this approach, it does have an immediate negative effect on cash flow and therefore interest earnings since Property Tax is only remitted twice a year. Additionally, cities have some concern about the State tampering with the allocation of the 1% local Sales Tax, which has always heretofore been assumed to be untouchable.

This section of the Fiscal Sub-element addresses the unique challenges and opportunities within each major source of City revenue. The focus of this section is on General Fund revenues, since by and large other Special Revenue or Enterprise funds are established to account for revenues that are earmarked for specific purposes. The change in composition of General Fund taxes and fees over the years is reviewed, along with major challenges and opportunities for the future.

GENERAL FUND REVENUES

General Fund revenues primarily consist of taxes and fees for a variety of services. Currently, five key sources generate 75% of the City's total General Fund revenue. They are: Sales Tax, Property Tax, Transient Occupancy Tax, Utility Users Tax/Franchise Fees, and Construction-related taxes and fees.

In the case of Sales Tax and Property Tax, the rates are set by the State and are uniform for all cities. However, the local taxes that are under the Council's control generally reflect rates which are lower than surrounding communities. For example, the Utility Users Tax is currently set at 2% which is well below the 3.7% countywide average and the 6% statewide average.

The Transient Occupancy Tax is now 8.5%, which is the lowest rate in Santa Clara County. This rate will rise to 9% in January 2007 and ultimately to 9.5% over the next three years due to a ballot measure approved by the voters in November 2005. Even at the higher 9.5% it will still be lower than the average of 10% in Santa Clara County.

In addition, Business License Tax rates in the City are very low when compared to surrounding communities. Voters also approved increases to the Business License Tax rates in November 2005 to bring them more in line with other cities and provide needed revenue for public services.

Following is a discussion of the City's top General Fund revenue sources and some potential future sources.

PROPERTY TAX

Property Tax now represents the largest source of General Fund revenue, accounting for over 30% of the total. Following the approval of Proposition 13 in 1978 and a several later legislative actions, Property Tax dropped substantially as a revenue source to local governments. However, Property Tax has now surpassed Sales Tax as our principal tax resource, primarily because of the State's "triple flip" legislation, which substitutes local Property Taxes in place of Vehicle License Fees.

Prior to Proposition 13, the City Council annually reviewed its revenue requirements and changed the property tax rate to match expenditures. When Proposition 13 passed, the tax rate for all taxing jurisdictions in California (exclusive of voter approved debt) was limited to 1% of full market value. Of the 1%, the City received approximately 12%, with the County, school districts, and special districts sharing the remainder. Proposition 13 had the immediate effect of reducing Property Tax revenue to Sunnyvale by two-thirds. In addition, the Proposition limited any increase in assessed valuation to 2% annually or the CPI, whichever is lower, except for property that changes hands or new improvements. The 2% limit has created inequities over the years, with one property paying substantially more than the taxes paid by an equivalent property because one has changed hands and has been re-assessed and the other has not. Additionally, residential property tends to change ownership more frequently than commercial property, which is often owned by a corporation. Some efforts have been made recently to establish a "split roll" wherein commercial properties are adjusted annually and are not subject to the 2% limitation. While these efforts have not been successful, it is likely that they will continue in some form in the future and may ultimately provide some additional revenue to local governments.

In the early 1990s, the State was faced with a series of budget shortfalls, and over a two year period the legislature permanently shifted a larger portion of the

Property Tax to schools. This shift was made to the State's Educational Revenue Augmentation Fund (ERAF) to backfill a portion of the State's obligation for school funding. This "ERAF shift" is now 3% of the Property Tax dollar, representing an annual loss to the City of Sunnyvale currently amounting to over \$7 million. Cumulatively, the total ERAF shift represented a loss of over \$70 million to Sunnyvale. During the State's budget crisis beginning in FY 2004/2005, the State shifted an additional \$4.1 million from Sunnyvale Property Tax to the ERAF ("ERAF III"). Fortunately this was not an ongoing shift and any further permanent shifts have been precluded by the passage of Proposition 1A in November 2004.

As discussed earlier, the Vehicle License Fee/Property Tax Swap has increased the Property Tax base in relationship to a reduction in Vehicle License Fee revenues. This increase is now permanent, and the new base now grows in the following years with the growth of Property Tax. Since the Vehicle License Fee revenue was unpopular and had the risk of being eliminated by the voters in a future initiative, the revenue shift was ultimately beneficial to cities. However, the Property Tax is paid twice a year, while the Vehicle License Fee was remitted monthly, and so the City has experienced a cash flow and interest earnings loss.

The City's Property Tax revenue consists of several categories. Secured Tax, which represents the vast majority of the overall Property Tax, is the tax on real property and the structures on that real property. Unsecured Tax represents the tax on assessments such as furniture, machinery, and equipment. Supplemental Tax is the result of reassessing the value of real property when there is a change of ownership or new construction is completed after the official lien date. The Supplemental Property Tax roll reflects properties that are sold or transferred after the official lien date. Supplemental assessments pick up the higher value on the property immediately by using a floating lien date, and the added assessed value is placed on a separate Property Tax bill. Revenue from the supplemental roll is dependent strictly upon timing of sales and thus is difficult to forecast. Other Property Tax revenues come from Unitary Tax, which is assessed by the State Board of Equalization on property such as railroad lines and utilities. Currently, the City receives penalties and interest on delinquent Property Taxes when they are paid.

Secured Property Tax tends to be relatively stable, and in Sunnyvale has gone up in recent years due to strong residential construction. In general, revenues from Secured Property Tax lag the economic cycle by at least one year because of the timing of the assessment and collection process at the County.

Unsecured Property Tax typically mirrors the local economic condition. Recent declines reflect the continued vacancy in our research and development and commercial buildings, the departure of several manufacturing facilities, and the continued hesitancy of businesses to expand operations and purchase or replace capital equipment. Unsecured Property Tax is projected to recover modestly in the next few years as our business base recovers from the Dot.com bust.

However, as a percent of our Property Tax revenue the Unsecured roll is expected to continue to decline as our business community changes from a manufacturing base to a knowledge and service base.

In the last decade, Property Tax revenue per capita has increased about 150%, as shown in the graph following. The growth has been particularly strong in FY 2004/2005 and FY 2005/2006 because of the Vehicle License Tax swap mentioned above and the strength of the residential construction sector. The pace of growth is expected to moderate beginning in FY 2006/2007 and in the foreseeable future.

SALES TAX

Sales and Use Tax represents the second largest source of revenue to the General Fund, making up more than 25% of City revenue. For a number of years following the passage of Proposition 13, Sales Tax far surpassed Property Tax as the City's largest revenue. In FY 1995/1996, for example, Sales Tax constituted 38% of General Fund revenue, while Property Tax equaled only 20%. However, due to the factors discussed earlier regarding Property Tax and the moderating of the City's economic growth, the two revenues have reversed position and become more equal.

Sales and Use Tax is composed of two different types - general retail sales and business-to-business sales. In Sunnyvale, as well as some other Silicon Valley cities, an unusually high proportion of overall Sales Tax has traditionally been business-to-business in nature; this sector currently constitutes approximately 40% of our aggregate as opposed to the statewide average of 17%. This makes our Sales Tax much more complicated and more subject to economic trends.

Sunnyvale's Sales Tax revenues have experienced wild swings over the recent years. In FY 1999/2000 and FY 2000/2001, the City experienced unprecedented growth of about 20% per year in Sales Tax receipts due to the "boom" in high technology business. Unfortunately, this level of revenue was not sustainable. The economic downturn that followed impacted City revenues for the four succeeding years, as the stock market was undergoing dramatic declines and numerous companies across the nation were implementing cost saving measures such as reducing capital investment.

The City's sustainable Sales Tax base has stabilized and is now experiencing a solid recovery, particularly in the business-to-business sector. Several new national retailers have also opened in Sunnyvale. Finally, stronger automobile sales have contributed to the increased revenues and added to our ongoing base. However, since the business-to-business use tax often results in large one-time receipts, caution must be used in forecasting ongoing Sales Tax revenues and identifying items which are not ongoing and do not add to the base.

Sunnyvale's ten largest businesses currently account for approximately 34% of total Sales Tax revenues, with three of these classified as business-to-business. Given the potential impact of changes in any one of these key businesses, staff will continue to closely monitor the composition of our largest Sales Tax producers.

UTILITY USERS TAX

Utility Users Tax (UUT) and Franchise Fees represent the third largest source of General Fund revenue, generating approximately 10% of the total. Historically, these two revenue categories have been combined because the primary source of City revenue for both is the sale of electricity and natural gas, although UUT on telephone usage has assumed greater importance in recent years.

The Sunnyvale UUT is a consumer tax on the consumption of electricity, gas and intrastate telephone communications services. Other jurisdictions apply the UUT to cable, interstate and international telecommunications, water, sewer and even sanitation services. Sunnyvale's UUT is levied at 2% of billed charges, collected by multiple service providers, and remitted monthly to the City. These rates are well below the statewide average of 6%. Currently the UUT revenue components break down as follows: 59% from the sale of electricity; 26% from intrastate telephone communications service and 15% from the sale of natural gas.

The City's UUT was first adopted in 1968. The tax rate has remained at 2%, with the exception of a brief voter-approved increase on electric and gas rates to 2.33% during the late 1990s in order to offset anticipated revenue declines due to statewide energy deregulation. By design, the tax increase was rescinded when the anticipated revenue decreases did not materialize. Tax revenues generated by the UUT are affected by market forces such as the supply/demand for energy and communications services, which in turn may affect rates charged to consumers. While in general UUT revenues have historically tracked with inflation, large increases or decreases in the cost of energy can result in larger swings in revenue. This occurred in the energy crisis in the early 1980s and more recently with a spike in natural gas prices from time to time.

Though the City's UUT revenue is projected to increase slightly less than inflation over the next ten years, certain developments in the telecommunications sector may negatively impact this projection, namely the rapid pace of technological change and the inability of government regulations to keep pace. Recent legislative activity at the federal and state level, and a ruling by the Internal Revenue Service on the Federal Excise Tax on telephone services pose the potential to reduce or eliminate revenues from cellular telephones. Since the City receives about \$1.6 million from telephone UUT annually, changes in this area will have a negative fiscal impact over the long term. At a minimum, the growing availability of alternatives such as Voice over Internet Protocol (VoIP) to

traditional phone service is reducing the overall cost to the consumer and therefore the taxable base.

Unlike the Utility Users Tax, a Franchise Fee is an obligation of the service provider, not of the consumer, and is an expense or cost of doing business, not a tax. Franchise fees, negotiated through franchise agreements with local entities, are paid by certain service providers who use the public rights-of-way, e.g., streets or easements. This revenue is then used to help fund the substantial costs necessary to maintain such public spaces. Currently, the City's main franchise agreements are with Pacific Gas & Electric (PG&E), Comcast Cable and Specialty Garbage. Franchise agreements may be based on a percentage of gross receipts, such as the City's agreements with PG&E and Comcast. Under the PG&E Franchise agreement, the City receives 1% of PG&E's gross receipts from electricity and gas sales in Sunnyvale (PG&E's franchise agreements across the State vary from 0.5% to 2%). Under the Comcast Franchise agreement, the City receives 5% of the cable provider's gross revenues.

While revenues from Franchise Fees have remained fairly stable and are not expected to show much change over the foreseeable future, recent changes in State law may have the effect of eroding Cable Franchise Fees over time. In 2006, California passed AB 2987, which grants video (cable) service providers a statewide franchise agreement, eliminating the local franchising process. The Federal government is similarly considering a national franchise, which would potentially preempt the new State law. The effect on franchise fee revenue is unknown at this time, but could well erode over time due to the new definition of gross revenues.

TRANSIENT OCCUPANCY TAX

Transient Occupancy Tax (TOT) represents the fourth largest revenue source of the General Fund, constituting about 5% of the total. Since 1978 the City has taxed charges for occupancy of hotel and motel rooms. Unlike many cities, Sunnyvale does not tie receipt of the Transient Occupancy Tax directly to support of the local convention and visitors bureau, but uses these funds to help pay for the services provided to those staying in the facilities.

The bulk of the City's Transient Occupancy Tax revenue stems from weekday business travel. Because both occupancy rates and room rates are closely linked to economic conditions, TOT revenue is particularly susceptible to business cycles.

Since bottoming out in FY 2003/2004, TOT revenues have been on the rise. Much of this is attributable to continued improvements in the average occupancy rate. Other contributing factors include expectations for continued increases in average occupancy rates and a slow rise in room rates.

In November 2005 Sunnyvale voters approved a phased increase to the Transient Occupancy Tax rate. In January 2007 the rate will rise to 9.0%, and the following January it will increase to 9.5%. This rate, when fully implemented, will still be less than the average Santa Clara County rate of 10%.

In general, Sunnyvale's hotel and motel properties have not kept pace with the newer facilities which have been constructed in the area during the last decade. As hotel stays have decreased overall in the region, consumers are choosing newer properties with more amenities in other cities. Further, in the last two years several of the City's hotel or motel properties have closed, including the large Four Points Sheraton site. Current plans are to replace that property with a smaller, higher end facility. Unfortunately, market conditions for hotel and motel construction are not favorable at this current time and plans may be delayed or changed. Any reduction in our number of hotel rooms or the quality of the accommodations will have a significant negative impact on our TOT revenue. Also, any increase in the number of rooms available in Santa Clara County outside of Sunnyvale will affect the occupancy rate of Sunnyvale hotels and the revenue received from the TOT.

BUSINESS LICENSE TAX

The City's Business License Tax (BLT) was adopted in 1968, and is assessed on businesses physically located in the City, as well as businesses outside of the City's boundaries that operate in the City. The BLT is a general tax, not a regulatory mechanism as in other jurisdictions. Though there are more than 8,000 Sunnyvale businesses, historically the BLT has generated less than \$250,000 per year. This was due to the BLT's low rate structure, which ranged from \$10-\$300 for businesses located in Sunnyvale and \$35-\$325 for businesses located outside of Sunnyvale. In addition, 80% of all taxpayers fall into the lowest chargeable categories of \$10 and \$35. The tax is applied to businesses based on the number of employees or rental units, whichever is higher.

In November 2005, Sunnyvale voters approved a stepped tax increase to the BLT that will take place over a two-year period from FY 2006/2007 to FY 2007/2008. The change in BLT rate will ultimately raise the minimum amount of tax to \$30 and the maximum amount to \$7,000 for rental units and \$9,500 for employee-based businesses. Capped amounts for both rental units and employee-based businesses will be phased over a three-year period ending in FY 2008/2009, at which time the tax and caps will be adjusted annually by the Consumer Price Index (CPI).

With the voter-approved tax increase, it is anticipated that revenues from the business license tax will increase by approximately \$800,000 to \$1,040,000 annually, with this amount increasing annually by the CPI. Given the normal peaks and valleys of business cycles, the BLT will remain somewhat volatile and difficult to project over the long term, especially given that approximately 80% of

all businesses fall into the lowest chargeable category and a higher proportion of smaller businesses would be negatively impacted by an economic downturn, affecting the BLT revenue collected by the City.

USER FEES AND CHARGES

A user fee is a charge imposed on an individual for a service that the person chooses to receive. It is established by law that a fee may not exceed the estimated full cost of providing the particular service or facility for which the fee is charged. Full cost is defined as the direct cost of service plus the indirect or overhead costs involved in providing that service. These indirect costs include departmental and city-wide administrative costs and support services such as building, technology, and fleet operations and equipment replacement. Cities have the general authority to impose fees (charges and rates) under the cities' police powers granted by the state Constitution (Article XI, sections 7 and 9).

The City sets fees for services to recover full cost where possible and legally allowed. All fees that are legally limited are analyzed periodically, to ensure that the City is setting fees in accordance with the legal requirements. In addition, City efforts focus on ensuring that those fees not legally limited provide full cost recovery for the services that are being delivered. A detailed subsidy analysis is conducted periodically on development fees that are charged by the Public Works and Community Development Departments. All fees are reviewed annually and adopted by resolution by the City Council. Each year an Annual Fee Schedule is prepared which serves as a record of all City fees.

There are specific procedures in state law for fee and rate adoption. Proposition 218 provides special rules for property-related fees used to fund property-related services.

Sunnyvale utility fees are based entirely on the City's costs for operating and maintaining its water, wastewater, and solid waste facilities and services. Each of the City's utilities is operated as an independent enterprise, and all expenses and revenues for each service are accounted for separately from other funds. No tax revenues are used to cover the costs of utility services, nor are any revenues from the Water Supply and Distribution, Wastewater Management or Solid Waste Management Funds used to support other City programs or services not related to utilities. A cost of service study is conducted periodically for each utility to ensure that the correct charges are being levied against each customer class.

With regard to Parks and Recreation services, the City golf course and recreation fees are generally market-based. The golf fees are updated annually and approved by the City Council after a survey of other comparable area golf courses is conducted. The City's Recreation Fees are set administratively after extensive staff analysis and review

DEVELOPMENT IMPACT AND MITIGATION FEES

Many new developments in the City, whether residential or commercial/industrial, large-scale or small, produce impacts on existing City facilities such as streets, storm drains, flood control systems, street lighting, and parks and community facilities. Through the land use planning process, cities may mitigate these impacts by requiring payment of fees or dedication of land as conditions of approval for development projects. The imposition of such requirements can be provided through a range of actions including general or specific plan adoptions or amendments, zoning, use permits, variances, subdivisions, building permit approvals, and development agreements.

Typically, development impact fees in the City are used for non-recurring capital improvement expenses and not to mitigate the impact of recurring operating costs. Currently, the City utilizes Park Dedication Fees, Housing Mitigation Fees, and Traffic Impact Fees to mitigate the various effects of development. These fees are charged on various bases depending upon the type of impact they are addressing and are set aside in separate funds to provide resources for the required capital improvements. In some cases, developers are required by the City to make specific improvements as part of their projects or provide partial or full funding if the improvement is considered to be directly related to the development project.

CONSTRUCTION RELATED REVENUE

Construction-related revenues constitute approximately 6% of General Fund revenues. This category includes Construction Tax as well as receipts from the issuance of building, electrical and other permits. Plan Check Fees are also reflected here. While permitting and plan check fees may be adjusted annually to reflect the cost of service provision, the Construction Tax may not be increased or decreased without voter approval.

The economic downturn caused the levels of construction-related revenue to drop significantly. However, in the last several years growth has been fueled by a large number of residential development projects, and this has produced an increase in these revenues to the City. Although Sunnyvale is a largely developed City, recent activity has centered around redevelopment of existing properties and this trend is expected to go on for some time.

REAL PROPERTY TRANSFER TAX

California law authorizes a county to impose a tax on the transfer of interests in real estate, with a city allowed to share in one-half of the county tax rate of fifty-five cents for each five hundred dollars of value. Sunnyvale adopted this tax rate in 1967. Revenues realized from the Real Property Transfer Tax are impacted both by the prices of real estate and the rate of turnover. Over the last few years the City has realized approximately \$1 million annually from this source.

Some charter cities have enacted a real property transfer tax outside of the county-administered tax by imposing a tax on the purchaser of real property based upon the value of the property. In these instances, the city would not share in the county rate, but would impose a higher tax. In most cases where a city has imposed its own tax, the rate has been substantially higher than the default rate. Palo Alto is an example of a local city with its own real property transfer tax and charges \$1.65 for each five hundred dollars of value. Imposition of such a local real property transfer tax in Sunnyvale would require a majority vote of the electorate as a new general tax.

EMERGENCY 911 ACCESS FEE

In continually seeking to diversify its revenue sources and achieve full cost recovery wherever possible, the City routinely identifies other potential sources of fee revenue. One such fee is the Emergency 911 Access Fee. This fee would offset the substantial costs of operating the City's Communications Center to receive and dispatch emergency 911 calls.

In 2004, the City Council approved the fee "in concept," but declined to enact the fee pending resolution of legal challenges in several local jurisdictions brought by the telecommunications industry. Two such lawsuits, against Stockton and Union City, contend that the fee is actually a tax requiring voter approval. As of the writing of this sub-element, the litigation is still pending. It is worth noting that the City and County of San Francisco has had an Emergency 911 Access Fee since the early 1990s and has not been legally challenged. Additionally, the City of San Jose began collecting an Emergency 911 Access Fee in January 2005 and reauthorized it again this year. The San Jose fee has also not been challenged.

Proposed Fiscal Indicators		2004/05	2005/06	2006/07
Fiscal Management - 7.1				
		Actual	Actual % Change	Projected % Change
Current				
X	Issuer Credit Rating			
X	Total City Revenue			
	Total City Expenditures			
	General Fund Revenues			
X	General Fund Expenditures			
X	Total Utility Funds Expenditures			
	Property Tax Revenue			
X	Sales Tax Revenue			
	Transient Occupancy Tax Revenue			
	Utility Users Tax Revenue			
	Franchise Fee Revenue			
	Business License Tax Revenue			
	Property Tax Per Capita			
	Sales Tax Per Capita			
	Total Assessed Valuation			
X	Outstanding General Obligation Bonds			
	Total Bonded Indebtedness Supported by General Fund Revenues 5% or Less of Assessed Valuation			
	Total Bonded Indebtedness for Capital Costs 30% or Less of Utility's Fixed Assets			
X	Commerical Water Utility Accounts			
X	Residential Water Utility Accounts			
X	Total Water Utility Accounts			
X	Total Number Licensed Businesses			
	Number of Local Businesses Receiving 1% Bid Preference			

LONG RANGE GOALS

- I. To make financial decisions over a 20-year planning horizon to allow decision-makers to consider the long-range implications of short-range budgeting decisions.
- II. To operate a performance based budget system which provides management with accurate measures of products and product costs, and motivation to continuously improve overall productivity, cost effectiveness, and quality of service.
- III. To design and maintain capital improvements to assure cost efficiency, accomplish City goals and policies, and minimize or reduce future operating costs.
- IV. To maintain sufficient reserves so as to maintain service levels during periods of economic downturn.
- V. To fund only those programs and projects which are consistent with the General Plan and which are anticipated to most cost-effectively implement the Plan.
- VI. To undertake full cost accounting for all City services to facilitate accurate resource allocation decisions and fee recovery.
- VII. To ensure accuracy and policy consistency in City processes and reporting through regular financial and performance audits of programs.
- VIII. To facilitate the smooth and timely purchase of needed goods and services while maintaining sufficient competitive bidding processes to deliver the lowest prices.

FINANCIAL POLICIES

BUDGET POLICIES

Development of the Budget and Resource Allocation Plan

1. The public will be encouraged to participate fully in the budget process.
2. A Fiscal Issues Workshop will be held each year prior to preparation of the City Manager's Recommended Budget to consider budget issues for the upcoming Resource Allocation Plan.
3. A balanced Twenty-Year Resource Allocation Plan shall be presented to the City Council annually.
4. The Twenty-Year Resource Allocation Plan shall be prepared on a two-year Operating Budget cycle.
5. The Operating Budget shall be approved annually with the second year approved in concept.
6. A proposed budget shall be recommended to the City Council by the City Manager no less than thirty-five days before the beginning of the fiscal year, in accordance with the City Charter.
7. At least one public hearing shall be held after the City Manager's Recommended Budget is presented to the Council in order to solicit public input before adoption.
8. The City Council shall adopt the City Manager's Recommended Budget, with any changes desired, by resolution before June 30th of each year.
9. Resources will be allocated in direct relation to General Plan goals.
10. The Resource Allocation Plan shall be prepared by General Plan element to link city resources with the accomplishment of General Plan goals.
11. New or expanded services should support the priorities reflected in the General Plan.
12. All competing requests for City resources should be weighed within the formal annual budget process.
13. Final actions on study items with significant financial impacts should be withheld until they can be made in the full context of the annual budget process.

Long Term Financial Planning

1. The City shall maintain a long term fiscal perspective by annually preparing a Twenty-Year Long Term Financial Plan for each fund. Those funds which account for intergovernmental grants will only include known entitlements.
2. Major financial decisions should be made in the context of the Twenty-Year Long Term Financial Plan.
3. Long term financial planning should enable the current service level provided to be sustained over time through the strategic use of reserves.

4. The Long Term Financial Plans should be used to communicate the fiscal impact of City decisions to all stakeholders whenever possible.

Performance-Based Budget System

1. The operating budget will be prepared and managed on a program basis.
2. All costs attributable to a budgeted program will be fully reflected in program budgets (with the exception of capital costs of general-use public buildings and facilities).
3. An emphasis should be placed on achieving maximum work productivity to ensure an optimal allocation of human and fiscal resources for Council approved services and programs.
4. All operating programs must identify the service provided, the service level, and the resources necessary to accomplish the specific service level.
5. A performance measurement system will be maintained and used for trend analysis and evaluation of effectiveness and efficiency of budgeted activities.

Budget Monitoring and Modification

1. Expenditures for each department are legally limited to the amount authorized by the City Council in the Budget Resolution, plus subsequent changes individually approved by the City Council through Budget Modifications.
2. The City's annual budget may be modified at any Council meeting by a majority vote of the City Council.
3. The City's budget appropriation control shall be by program within the same fund for operating programs in the General Fund and Special Revenue Funds. For the Proprietary and Internal Service Funds, expenditures cannot exceed actual revenues plus the planned use of reserves.
4. Appropriations for capital and special projects shall be limited to the amounts contained on the Budget Resolution for each project. All modifications to project budgets require Council approval.
5. Budget reappropriations among programs within a Department and Fund may be authorized by the City Manager if service levels as approved by City Council are maintained.
6. Any unexpended appropriations shall expire at fiscal year-end unless specifically reappropriated by the City Council for expenditure during the new fiscal year.

REVENUE POLICIES

Revenue Base

1. The City will maintain a diversified and stable revenue base, not overly dependent on any land use or external funding source.
2. Taxes levied by the City will be used for the purpose of financing services performed for the common benefit.
3. Taxes should be held at their lowest possible level, while maintaining Council-approved service levels.
4. When considering a new tax or revenue source or an increase in an existing tax or revenue source, the following criteria should be considered:
 - Community/voter acceptance
 - Competitiveness with surrounding communities
 - Efficiency of revenue collection and enforcement
 - Effectiveness in generating sufficient revenues in the short and long-term to justify its establishment
 - Enhancement of revenue diversity to promote stability and provide protection from downturns in business cycles
 - Equity/Fairness in distribution of the revenue burden on various segments of the community
5. Reliance on any restricted and/or inelastic sources of revenue will be avoided.
6. One-time revenues should not be used for ongoing expenditures.
7. Revenue should not be targeted for a specific program, unless a revenue source has been established for the sole purpose of financing a particular expenditure.
8. Potential new revenue sources will be investigated periodically to ensure that the City's revenue base is stable and diversified.
9. Donations, contributions, and sponsorships may be accepted if they are in accordance with City policy and General Plan priorities.

Revenue Forecasting and Monitoring

1. All revenue estimates must be conservative, objective and reasonable.
2. Revenue forecasts should be based on detailed information regarding historical performance and economic conditions whenever possible.
3. At least ten years data for all tax revenue sources will be maintained.
4. Revenues will be estimated for the budget year and for each planning year in the Twenty-Year Resource Allocation Plan.
5. Methods to maximize the accuracy of revenue forecasts will be established.
6. Estimated revenues from grant sources will be projected only to the specific date on which the entitlement will end.

7. Estimated intergovernmental revenues for which the City is eligible (but which are not guaranteed) will be forecast to assure that local matching funds will be available if the revenues are realized.

Revenue Collection

1. The City will seek all possible Federal and State reimbursement for mandated projects and/or programs.
2. An aggressive collection system for all accounts receivable, including utility receivables, will be utilized to assure that monies due to the City are received in a timely fashion.
3. Monthly reviews and periodic audits of Transient Occupancy Tax returns will be conducted.
4. Monthly reviews and periodic audits of all major locally administered revenue sources will be conducted.
5. Periodic point-of-sale audits for Sales Tax will be conducted.

Grants and Intergovernmental Assistance

1. The use of intergovernmental grant assistance for routine programs will be discouraged. Intergovernmental grants may be used for special projects which strengthen a program, have a definable starting and ending date, and do not expand a service in such a way as to require the substitution of local funds to continue part or all of the service once intergovernmental assistance ends.
2. Intergovernmental assistance may only be used to establish or expand a program when the Twenty-Year Resource Allocation Plan meets the following conditions:
 - The program is eliminated at the end of the intergovernmental funding period, or
 - The program continues with the requisite local funding in the Twenty-Year Resource Allocation Plan upon completion of intergovernmental funding
3. A uniform grants application process must be utilized to assure that the City Council has the information necessary to make a decision regarding a potential intergovernmental grant. Staff should present to Council a Notice of Intent regarding a possible grant source which shall include at least the following information:
 - The grant being pursued and the use to which it would be placed
 - The objectives or goals of the City which will be achieved through use of the grant
 - The local match required, if any, plus the source of the local match
 - The increased cost to be locally funded upon termination of the grant
 - The ability of the City to administer the grant

User Fees

1. User fees should be used to recover the cost of services that benefit specific segments of the community.
2. User fees should be reviewed and adjusted at least annually to avoid sharp changes.
3. User fees and charges should not exceed the City's full cost of providing the service.
4. User fees should be established at a level which reflects the full cost of providing those services.
5. The City Council may determine for any service whether a subsidy from the General Fund is in the public interest.
6. User fees shall only be used when the cost of providing the service can be readily calculated and administered.
7. User fees should be adopted by Council resolution and included in the Annual Fee Schedule.

*Note: For additional user fee policies specific to the Utility Funds or the Community Recreation Fund, please see those sections under Enterprise Fund policies.

CAPITAL IMPROVEMENT POLICIES

Capital Improvement Plan

1. An updated Twenty-Year Capital Improvement Plan shall be prepared on a two-year budget cycle.
2. The City shall fund only those Capital Improvement Projects that are consistent with the adopted Capital Improvement Plan, City priorities, and General Plan goals.
3. High priority should be given to replacing capital improvements prior to the time that they have deteriorated to the point where they are hazardous, incur high maintenance costs, negatively affect property values, or no longer serve their intended purposes.
4. New or expanded capital improvements should maximize value and avoid duplication whenever possible by partnering with other entities to pool resources or share facilities.
5. Priority will be given to the repair and replacement of existing infrastructure as compared to the provision of new or expanded facilities.
6. The decision on whether to repair or to replace an existing capital asset will be based on which alternative is most cost-effective or provides the best value to the City.
7. The operating impact of proposed capital projects, including ongoing operating expenditures, capital outlay, debt service, and infrastructure replacement will be identified in the Capital Budget and considered in the selection of projects for funding.
8. Staff will identify the estimated costs, potential funding sources, return on investment, project schedule and relationship to the General Plan for each capital project proposal before it is submitted to the Council for approval.
9. Capital improvements should be maintained to the level required to adequately protect the City's capital investment and to minimize future maintenance and replacement costs.
10. A Capital Projects Fund shall be used to account for major capital acquisition or construction projects associated with the General Fund and other governmental funds. The capital projects of the Utility Enterprise Funds shall be accounted for within the respective fund.
11. The Infrastructure Renovation and Replacement Fund shall be used to account for projects related to the City's Long-Range Infrastructure Plan for the renovation and replacement of existing general City assets. Infrastructure projects related to the City's utilities shall be accounted for in the respective utility fund.

Funding

1. Governmental capital improvements should be funded on a “pay-as-you-go” basis in most cases. Alternate financing strategies may be considered in light of the specific project and the consequences of each financing strategy.
2. Development-related improvements such as sidewalks, curbs and gutters, street lights, and water and sewer lines should be funded by those directly benefiting from the improvements.
3. The City will seek out and use intergovernmental funding sources for capital improvements, as is consistent with City priorities and General Plan goals.
4. Funds for the replacement of City assets originally paid for by a developer should be included in the Capital Improvement Plan of the appropriate City fund.

Design and Evaluation

1. The planning and design of capital improvements should be based on standards that minimize construction costs, while assuring acceptable useful life and reducing maintenance requirements. Value engineering processes will be utilized when necessary and appropriate.
2. Budgeting for capital projects must reflect when the expenditures are scheduled to occur, using multi-year planning to ensure a reasonable time frame for projecting costs.
3. Improvements should be designed with the following goals: to maximize energy efficiency, require minimal maintenance, create an efficient physical relationship for those working in the facility, provide adequate capacity for the projected useful life, and to have the ability to accommodate future expansion with minimum remodeling costs.

LAND POLICIES

Acquisition, Disposition and Leasing of City-Owned Real Property

1. A high priority will be given to acquiring undeveloped land needed to meet City goals before it is developed.
2. Developed land should be acquired in reasonable proximity to the time the property is required for City purposes.
3. Every effort shall be made to acquire property through negotiation, reserving the use of eminent domain for those circumstances when immediate possession is required and the property cannot be acquired through negotiation at a cost approximating market value.
4. The purchase, sale or lease of real property where the purchase or sale price or lease cost is more than \$75,000 shall be approved by the City Council.
5. The purchase, sale or lease of real property where the purchase or sales price or lease cost is less than \$75,000 shall be approved by the City Manager.
6. The lease of city property which results in revenue to the City and the term is less than or equal to 55 years shall be approved by the City Manager.
7. The lease of city property for a term longer than 55 years shall be authorized by the City Council by resolution following a public hearing.
8. Property leased to outside entities should be based on market rents except when the Council finds that there is a public purpose for leasing at a lower rate.
9. The net proceeds from the disposition of surplus City property owned by the General Fund shall be placed into the General Fund Reserve for Capital Improvements.
10. Proceeds from the sale of land or facilities originally purchased with monies from a specific fund should be kept within that fund.

RESERVE POLICIES

General Fund Reserves

1. The City shall maintain a General Fund Contingency Reserve of at least 20% of operating expenditures to cover emergencies or disasters.
2. The sale of surplus property owned by the General Fund and any other one-time revenues shall be placed into a Reserve for Capital Improvement Projects to be used for capital improvement or expansion.
3. The Twenty-Year Resource Allocation Plan (RAP) Reserve shall be used to levelize economic cycles and maintain stable service levels over the long term.
4. The Twenty-Year RAP Reserve should be balanced to zero in the twentieth year of the Long Term Financial Plan. This means that the reserve increases during periods of economic growth and has planned draw-downs during low periods of the economic cycle.
5. The Service Level Set-Aside will be used to provide ongoing funds to increase service levels or add new services. Once used, this Set-Aside may be replenished according to economic conditions.
6. Any other reserves may be established to segregate funds which are legally restricted to specific purposes.

Internal Service Fund Reserves

1. The City will establish and maintain an Equipment Replacement Reserve to provide for timely replacement of the City's fleet, furniture and fixtures, technology and communication equipment.
2. Reserve levels for each type of equipment will be established based on the lifecycle of existing assets accounted for in the appropriate Sub-Fund of the General Services Fund.
3. Equipment replacement expenses should be amortized through the use of rental rate charges to be fully funded by users.
4. The Workers' Compensation Reserve shall be maintained at a level deemed adequate to meet projected liabilities as determined by an actuarial evaluation.
5. The Liability and Property Reserves will be maintained at a level which, together with purchased insurance policies, will adequately indemnify the City's property and liability risk. A qualified actuarial firm shall be retained in order to recommend appropriate funding levels.
6. An Actuarial Retiree Medical Reserve will be maintained at a level that is deemed adequate to meet projected liabilities as determined by an actuarial evaluation. This Reserve should meet the GASB reporting requirements for these future costs.

7. Rate Uncertainty Reserves will be funded for those employee benefits expenditures exhibiting high volatility or significant increases. The reserves will ensure adequate funding while minimizing the effect on the funding of other City operations.

DEBT MANAGEMENT POLICIES

Debt Limits and Debt Capacity

1. Total bonded indebtedness supported by General Fund revenues should not exceed 5% of assessed valuation of property within the City. Bond issues supported by the General Fund should be restricted to annual debt service of 5% of General Fund revenue.
2. Land based financings should maintain a minimum property value-to-debt ratio of 3:1, with exceptions made for special circumstances at Council's discretion.
3. Debt service should not affect the City's ability to meet future operating, capital and reserve requirements.

Debt Issuance

1. Debt should be used only to finance improvements that cannot be paid for with current revenues, unless the purpose of the debt is to spread improvement costs over a longer period of time and ensure that future users become responsible for portions of the cost.
2. There should be no short-term (debt) borrowing to support routine operations unless (a) the borrowing will be at a lower interest rate than the rate on invested funds, and (b) funds are available for routine operations.
3. An internal feasibility analysis will be prepared for each long-term financing which analyzes the impact on current and future budgets.
4. Bond issues should be scheduled to equalize annual debt service requirements to the degree that borrowing costs can also be minimized.
5. Generally, the method of financing selected for debt issuance should be based on who will benefit and who should pay for the cost of improvements. The following are guidelines:
 - General Obligation Bonds – For major improvements that are of community-wide benefit and use, such as general municipal facilities and parks. These are funded by ad valorem taxes and require 2/3 voter approval.
 - Assessments - For new subdivision improvements and for City improvements where the Council has determined that a specific benefiting group should be responsible for payment.
 - Tax Increment Bonds - For improvements in the Redevelopment Project Area where rehabilitation or redevelopment is required. These bonds are financed by tax increment from the project to be developed.
 - Certificates of Participation - Where backing by the full faith and credit of the City is the most cost-effective method. If this method is proposed, a full cost analysis will be done.

- Revenue Bonds – All City utility-related improvements shall be funded only from revenues of the respective utilities.
- 6. The maximum term of each bond issue should be no longer than the expected useful life of the asset financed.
- 7. Refunding of outstanding bond issues shall be considered if the net present value savings is at least 3%, or if it is necessary to remove a burdensome or restrictive bond covenant.
- 8. The City will consider requests for conduit financing on a case-by-case basis, taking into consideration the borrower's credit worthiness, the purpose of the borrowing and its relationship to City priorities, and any impact on the City's financial position.
- 9. Debt financings will generally be conducted on a competitive basis. However, negotiated financings may be used due to market volatility or the existence of an unusual or complex financing or security structure.
- 10. Fixed or variable rate financing may be used, depending on the cost benefit to the City of each option.

Debt Management

1. The City will diligently monitor its compliance with bond covenants and ensure adherence to federal arbitrage and disclosure regulations.
2. Debt financing should not exceed the anticipated useful life of an improvement.
3. The City will seek to maintain and, if possible, improve its current bond rating(s) in order to minimize borrowing costs and preserve access to credit.
4. A Debt Service Reserve shall be maintained for each debt issue as required by the respective bond covenants.

ACCOUNTING POLICIES

Accounting Principles

1. A Comprehensive Annual Financial Report (CAFR) will be prepared each year within six months of the close of the previous fiscal year.
2. The CAFR shall be prepared in accordance with generally accepted accounting principles applicable to local governments, and shall receive an unqualified opinion by the City's independent auditor each year.
3. The Government Finance Officers Association (GFOA) Certificate of Achievement for Excellence in Financial Reporting should be pursued annually.
4. The accounting system shall provide a mechanism to fund accrued benefits liabilities.
5. Pension obligations will be fully funded annually and current pension contributions will not be deferred to balance current expenditures.
6. An integrated accounting and budgeting system will be maintained so that production and cost for each activity can be calculated and evaluated.
7. The City Council shall be provided with periodic summary financial reports, by fund, comparing actual revenues and expenditures to budgeted amounts.
8. The City shall maintain a full cost accounting system.
9. A city-wide Cost Allocation Plan shall be developed to identify the cost of administrative support for all City departments and special funds.
10. The "modified approach" to account for streets infrastructure capital assets, as defined by GASB No. 34, shall be utilized for the City's street network. The City Council will establish a range of acceptable condition levels for the street network on a biennial basis and the City Manager will set the actual target condition level(s) each year.
11. The City shall establish such separate funds as required by law to account for grant funding and other revenues limited to specific use.
12. Internal Service Funds shall be used to account for the financing of goods and services provided by one department or agency to other departments or agencies of the City.
13. Internal Service Funds shall be used to equitably distribute facility, vehicle and equipment replacement and maintenance costs among City user departments and to assure that adequate funding is on hand to replace/maintain assets and pay liabilities.
14. Internal Service Funds shall be maintained to account for employee benefits and to provide a mechanism to fully fund accrued benefit liabilities.

Internal Controls

1. A system of effective internal controls shall be maintained that assures only properly authorized expenditures, recordings of financial transactions, and

accounting entries are executed and provides for the physical security of City funds and assets.

2. Periodic financial reviews will be conducted to assure that adequate internal controls exist, at a reasonable cost, and that fiscal practices are in compliance with Federal, State and City rules and regulations.
3. Operational audits will be conducted to evaluate the efficiency and effectiveness of City functions.
4. Performance audits will be conducted regularly on a schedule set by Council to verify that the performance data reported by each Department is complete, valid and accurate.
5. The City's cash handling practices shall be reviewed at least quarterly, as required by the City Charter, in order to safeguard the City's cash assets.

PURCHASING POLICIES

Centralized Purchasing System

1. Whenever possible, purchases will be made through a competitive bid or proposal process.
2. Purchasing policies and procedures will be as fair and open as possible so that everyone involved will understand the elements of the process, including procedures, timelines, expectations, requirements, and criteria for supplier selection.
3. A preference of 1% shall be given to local businesses in the evaluation of bids and proposals in the procurement of goods. Contracts exempt from this preference are:
 - Emergency procurement
 - Sole source contracts
 - Contracts funded from grants, donations, or gifts with special conditions that specify otherwise
4. Purchases of goods and services will be made from locally owned businesses whenever possible, in accordance with purchasing regulations.
5. The City will actively seek opportunities to participate with other public agencies in the development of competitive bids that combine purchasing power to achieve volume pricing.
6. City staff shall not use their position for personal gain in any procurement.
7. Environmentally responsible procurement policies will be used where possible, to encourage recycling, reduce waste, conserve energy and natural resources and protect environmental quality.
8. Technological advances that present more efficient and effective ways to purchase goods and services will be encouraged.
9. An efficient and effective system of inventory management for City-stocked items and for sale or disposal or surplus items will be maintained.

ENTERPRISE FUND POLICIES

Utility Fund Policies

Accounting and Fund Management

1. The financial activities of each utility should be accounted for in a separate fund.
2. The City will assure that all direct and indirect costs of each utility are fully cost-accounted.
3. Expenses which are incurred to support more than one utility should be allocated to each utility in a manner that reasonably reflects the benefit received.
4. Each utility fund shall reimburse the General Fund, and/or other applicable funds, for the full cost of general government support services provided to that utility.
5. The user fees established for each utility will be reviewed annually and set at a level that will support the total costs of the utility, including direct and indirect costs and contributions to reserves set by Council policy.
6. In the event that any utility requires one-time resources from other City funds to support its operations, or that the utility provides resources to an unrelated program, the use of these funds should be accounted for as an inter-fund loan.
7. Debt service coverage should be maintained for each bond issue as required by the bond covenants.
8. No utility resources shall be used to fund unrelated General Fund services.

Capital Program

1. Capital improvements associated with the existing infrastructure of a utility should be primarily funded from two sources: rate revenue and debt financing.
2. New improvements or expanded capacity in any utility should be funded by those benefiting through specific charges, such as connection fees, impact fees, or mitigation fees.
3. Local, state, and federal funding sources, such as grants and contributions, should be pursued for utility-related capital improvement projects consistent with City priorities.
4. Water and wastewater improvements should be designed and constructed to the size required to serve the City's capacity needs when fully developed plus any required redundancy to assure reliable operation and provision of service.
5. Bonded debt financing should be used for capital improvements as appropriate to:
 - Make cost recovery of an asset more consistent with its useful life

- Equitably assign cost over multiple generations of customers who use the assets
 - Smooth near-term rate impacts of the project
6. Total bonded debt should equal no more than 30% of the utility's fixed assets.
 7. Resources for the capital requirements of each utility such as bond proceeds or connection fees should be dedicated only for capital projects and not be used for ongoing maintenance and operations.
 8. The annual depreciation expense of the assets of each utility should be set aside into a Rehabilitation and Replacement Reserve as a minimum funding level for system replacement.

Reserves

1. A Contingency Reserve of 25% of operating expenses shall be maintained in the Water and Wastewater Funds to allow approximately 90 days of working capital in case of emergency.
2. A Contingency Reserve of 10% of operating expenses shall be maintained in the Solid Waste Fund. This lower reserve is appropriate because the asset value of the Solid Waste Fund is substantially smaller than the other city utilities, and because operations are performed by contract, with insurance and bonding requirements as part of the contract assuring the continued operation in the case of an emergency.
3. In the event that the Contingency Reserve of any utility fund is used it shall be replenished by the end of the following fiscal year or as soon as practical thereafter considering the circumstances that prompted the need to use the reserve.
4. A Capital Replacement Reserve shall be maintained in the SMaRT Station Replacement Fund to account for contributions from the three participating cities for the replacement of City-owned SMaRT Station equipment.
5. A Rate Stabilization Fund shall be maintained in each utility fund to levelize the rates and annual rate increases in light of fluctuations in financial requirements from year-to-year.
6. A Capital Rehabilitation and Replacement Reserve for each utility should be established to provide resources for the infrastructure replacement needs of the respective utility system. This reserve should act as a sinking fund for annual depreciation expense of the utility assets.
7. Debt service reserves should be maintained for each bond issue as required by the bond covenants.

Community Recreation Fund Policies

Fund Management

1. The General Fund subsidy received by the Community Recreation Fund shall be fixed at the FY 2006/2007 level as the base year and increased annually by the inflation factor included in the recommended budget for the upcoming year.
2. Any increase in service levels by City Council not covered by an increase in revenues will result in a corresponding increase to the General Fund subsidy.
3. Any action by City Council to decrease revenues of the Community Recreation Fund not covered by a decrease in operating costs will result in a corresponding increase to the General Fund subsidy.
4. The infrastructure rehabilitation and replacement of all facilities on park land, including the golf courses and tennis center, will be funded first through the Park Dedication Fund if funds are available.
5. A Fee Waiver system should be provided to allow persons who are economically disadvantaged to participate in and utilize programs, facilities, and services provided by the Community Recreation Fund. The criteria for eligibility in this system shall be established by Council policy.

User Fees

1. Golf fees shall be set annually utilizing market-based comparisons and included in the City's Annual Fee Schedule adopted by Council resolution.
2. User fees for recreation services shall be set administratively by the Director of Parks and Recreation in accordance with a documented methodology that depicts a relationship to cost recovery, market forces, and adjustments based on such factors as:
 - Perceived benefit to the community
 - Pricing which favors Sunnyvale residents over non-residents
 - Target populations
 - Promotional and marketing considerations
3. The fees established administratively by the Director of Parks and Recreation shall be published at least twice a year.

Reserves

1. The Community Recreation Fund shall maintain a Twenty-Year Resource Allocation Plan Reserve to stabilize economic cycles and maintain service levels over the long term.
2. Any fund balance remaining in the Community Recreation Fund shall remain in the Fund for use in subsequent years.
3. The Community Recreation Fund will maintain a Co-op Sports Reserve to administer the after school intra-mural sports league programs at Sunnyvale

Middle School and Columbia Middle School as required by agreement with the Sunnyvale School District.

ACTION STRATEGIES